STUDENT TEXT For Use in Preparing Tax Year 2002 Returns

VOLUNTEER ASSISTOR'S GUIDE



FOR USE IN IRS VOLUNTEER PROGRAMS VITA Volunteer Income Tax Assistance TCE Tax Counseling for the Elderly

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The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.



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As always, please make sure that you have the latest tax forms instructions, forms, schedules, charts, and worksheets, when assisting taxpayers.

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Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.



DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE ATLANTA, GA 30308

WELCOME, VOLUNTEERS!

Through the assistance of trained volunteers from the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs, the Internal Revenue Service is able to offer free tax help to low to moderate-income taxpayers. As a volunteer, you will help prepare tax returns for a taxpayer segment which often includes seniors, disabled, and non-English speaking people and others who cannot afford professional tax assistance.

This publication will help you to acquire the skills to prepare basic tax returns. There are two tracks to certification – the Wage Earner and the Pension Earner. The Wage Earner track covers issues working individuals and families customarily face. The Pension Earner track contains more complex issues, those generally encountered by retired people and senior citizens. These tracks allow instructors to train volunteers in specific tax issues encountered at the volunteer sites. For instance, a TCE class might certify their volunteers on the Pension Earner track that does not include training on the Earned Income Tax Credit (EITC). If the instructor or the site coordinator anticipates that taxpayers coming into the site will be eligible for the EITC, he/she can also teach, test, and certify volunteers on the EITC chapter, a portion of the Wage Earner track.

IRS *e-file*. After completing this class on basic tax law, I urge you to learn how to electronically file (*e-file*) the returns you prepare. Electronic filing (*e-filing*) uses automation to quickly check for errors or missing information. Consequently, *e-filed* returns have a higher accuracy rate than paper prepared returns. Taxpayers who have their returns filed electronically receive their refunds in less than half the time paper filers do and, with Direct Deposit, in as few as 10 days. Ask your instructor or site coordinator for information on our electronic filing classes.

Comments and recommendations. I welcome your comments and recommendations about our training material. Your instructor or site coordinator can take your suggestions or you can write to us at the following address:

Internal Revenue Service Stakeholder Partnerships, Education and Communication W:CAR:SPEC:PPD:E, Stop 45-WI 401 W. Peachtree Street, NW Atlanta, GA 30308

I thank you in advance for your willingness to volunteer your own time to provide this much needed service to your neighbors and your community.

Sincerely,

Mark E. Pursley

Director, Stakeholder Partnerships, Education and Communication

Mark E. Tusten

Important Changes and Reminders for 2002

Exemption amount increased. The amount you can deduct for each exemption has increased from \$2,900 to \$3,000.

Standard deduction amount increased. Your standard deduction if you do not itemize deductions on Schedule A (Form 1040) is higher in 2002 than it was in 2001. The amount depends on your filing status.

Student loan interest deduction increased. The maximum amount of interest you can deduct on a qualified student loan is \$2,500.

Standard mileage rate. The standard mileage rate for the cost of operating a car is 36.5 cents a mile for all business miles driven.

Kidnapped children. Parents of a child who has been kidnapped by someone who is not a family member may be able to take the child into account in determining

- Head of household or qualifying widow(er) wih dependent child filing status,
- An exemption for the child,
- · The child tax credit, and
- The earned income credit.

For more information, see Publication 501, Exemptions, Standard Deduction, and Filing Information.

Restitution payments to holocaust victims exempt from income. Holocaust victims, their heirs or estates can exclude from income certain restitution payments received on or after January 1, 2000.

Education IRAs renamed Coverdell ESAs. Education individual retirement accounts (education IRAs) have been renamed Coverdell education savings accounts.

Tuition and fees. Beginning in 2002, taxpayers can deduct an amount equal to the qualified tuition and related expenses paid during the tax year as an adjustment to income. The adjustment is reported on Form 1040, line 26 or Form 1040A, line 19.

Educator expenses. Eligible educators can deduct as an adjustment to income up to \$250 in qualified expenses. These expenses are deductible even if he or she does not itemize deductions on Schedule A (Form 1040). This adjustment is for expenses paid or incurred in the years beginning during 2002 or 2003. Previously these expenses were deductible only as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit. The adjustment is reported on Form 1040A line 16 or Form 1040 line 23.

Earned income credit. Beginning in tax year 2002, some of the rules and qualifications for EIC changed. New rules and/or qualifications apply to earned income, modified adjusted gross income, taxpayers with the same qualifying child and a new definition of foster child.

Important Changes The *tie breaking rules* for purposes of the earned income credit provided that if the parents do not file a joint return together, the child will be the qualifying child of the parent the child lived with for the longest period of time during the year, or if the child lived with both parents for an equal amount of time during the year, that child is the qualifying child or the parent with the highest adjusted gross income.

Retirement savings contributions credit. Beginning in 2002, if the taxpayer contributes to a retirement plan or an IRA, he or she may be eligible for the saver's credit. This is a nonrefundable credit. The taxpayer's filing status adjusted gross income, credit rate and the qualified contributions determine the amount of the credit. IRA deductions increase from \$2,500 to \$3,000 (to \$3,500 if 55 or older).

Medical expenses. Certain weight loss programs to treat diseases diagnosed by physicians including obesity are deductible as an itemized deduction reportable on Schedule A. Additionally, the costs of purchasing diet food items are also considered allowable medical expenses.

Coverdell ESAs. Beginning in 2002, taxpayers can receive tax-free distributions from Coverdell ESAs to pay for postsecondary education and public, private and religious elementary and secondary schools.

IMPORTANT NOTE

Bring your **Social Security Card(s)** with you next year.

The Internal Revenue Service verifies all of the names and social security numbers listed on your return with records from the Social Security Administration. If the name and the number that you list on your return do not match the Social Security Administration records, your return may be delayed. Allowing us to view the **social security card** helps us ensure that the name and number entered on your return are correct. If you do not have a social security card, please request one from the Social Security Administration before seeking assistance with your taxes.

Introduction and **Administrative G**uidelines

VOLUNTEER TRAINING

Welcome to the Internal Revenue Service's (IRS) Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs! These volunteer programs are very important to the IRS. As an IRS volunteer you provide a tremendous service to the American public and to your community. You are about to embark on a very challenging and rewarding task as an important player in tax administration.

Every year thousands of volunteers assist millions of taxpayers with their federal return. The people receiving your assistance need it the most. They are those with limited incomes, individuals with disabilities, non-English speaking, and the seniors. Thank you for your hard work and dedication!

This section highlights important changes to the VITA and TCE programs.

VITA/TCE overprint: As of October 1, 2002, you no longer have the responsibilities of reporting statistics using Form 6522. We will capture all of our statistics from internal reports. Each paper or electronically filed return should be identified with the appropriate "VITA or TCE" acronym. This will ensure that all volunteer prepared returns are correctly counted once received by the Internal Revenue Service.

Social Security Cards: One of the primary reasons for the rejection of a return or a delay in processing a return is an incorrect SSN. It is important, therefore, that you check the accuracy of each SSN, as well as the spelling of the name associated with the number.

e-file: Each year the IRS contracts with a software developer to provide tax return preparation software. All returns prepared using the software should be electronically filed. The only exception is when a return is filed electronically with the IRS and you experience unworkable rejects.

Scope and Sequence

We have re-organized this training manual. The new organization will help to better train you to assist the taxpayers you see day to day. Most taxpayers are either wage earners or pension earners. Therefore, we have organized this training material in three modules: basic, wage earner, and pension earner. There

are instances where a site serves both wage earners and pension earners. Your instructor has worked closely with the coordinator(s) at the site where you will assist taxpayers to determine which lessons you should learn.

Basic Module

All volunteers must complete the following lessons:

Lesson 1—Introduction

Lesson 2—Getting Started

Lesson 3—Income

Lesson 4—Adjustments

Lesson 5—Standard Deduction and Itemized Deductions

Lesson 6—Credit for Qualified Retirement Savings Contributions, Mortgage Interest, and Foreign Tax Credit.

Lesson 7—Finishing the Return

Wage Earner Module

Volunteers who will be assisting wage earners need to complete the following lessons:

Lesson 8—Credit for Child and Dependent Care

Lesson 9—Education Credits

Lesson 10—Earned Income Tax Credit

Lesson 11— Child Tax Credit

Pension Earner Module

Volunteers who will be assisting pension earners are required to complete the following lessons.

Lesson 12—Sale of Stock

Lesson 13—Sale of Home

Lesson 14—Pensions

Lesson 15—Credit for Elderly or Disabled

Those who are taking this training with the expectation of becoming instructors themselves must learn all lessons.

The sequence of lessons generally follows the order of topics on the tax returns which you will complete at the volunteer site. In a few instances, this does not parallel the order of the tax form itself. For example, while the entity section (taxpayer's name, address, and social security number) appears first on the form, it is covered in the lesson on finishing the return since it is one of the last things to do when completing the return. (Have you ever tried to peel off one of the stick-on labels after you have found an error on the return?)

It is very important for you to assist only with returns and supporting schedules and forms for which you have been trained. If you go beyond your training, you risk making errors and causing difficulties for those you wish to help. Refer taxpayers with difficult returns, or with portions of returns that are beyond the scope of your training to a paid professional tax preparer.

There are separate training materials available for the following categories of taxpayers:

Publication 678FS—Foreign Students and Scholars Publication 678IN—U.S. Citizens and Residents Abroad Publication 678M—Military Issues Publication 678PR—Tax Issues for Puerto Rico

As a volunteer, you are not allowed to charge for your services. This includes taxpayer return preparation advice and return preparation. You may at times need to remind taxpayers that the assistance that you are providing is **FREE**. Do not solicit or accept donations on behalf of the VITA or TCE sponsor, or any other individual or organization, while providing assistance in this program.

Assisting taxpayers includes helping to make sure they are aware of their rights. Publication 1, *Your Rights as a Taxpayer*, is available free, from the IRS. Taxpayers can help ensure that they receive fair treatment in tax matters when they are aware of their rights.

Testing

All volunteers must take the applicable test to show that they can complete returns accurately. You may use this text and all reference materials to complete the test. Volunteers who do not pass the test may take the appropriate retest. Instructions on taking and grading the test are in the Test and Retest Booklets.

Proof Copies of Forms

Forms imprinted with "draft" were current as of the date this publication was sent to print. Final forms may have supplemental changes. Be sure to compare the final forms with those in this publication and *The Tax Forms Booklet Appendix*, which was part of the Publication 678 Package, before helping taxpayers with their returns.

Exercises and Exhibits

It is important that you take the time to complete the exercises to achieve the objectives in each lesson. Studies have shown that long-term retention of information increases dramatically if you put pencil to paper in responding to questions and problems. The Volunteer Assistor's Guide is your learning tool and you may mark it up in any way you wish.

Each exercise is separated from the rest of the text by a border design. Write out your answer to each exercise, and then check it immediately against the answer provided. If your answer is different, work the problem again. If you need additional reinforcement, review any parts of the text that apply.

The exercises are designed to give you practice, to emphasize what we think is important, and to help you complete your training successfully.

The coursebook contains a large number of exhibits of the various tax forms and schedules. These exhibits are numbered starting at the beginning of each lesson. Many of the exercises contain exhibits of blank forms, or part of the form, that you must complete.

Lesson Features

Introduction

There is a brief **Introduction** to each lesson. This will give you an overview of the topic to be covered, as well as an idea of how you will most likely be asked to apply the information when helping taxpayers.

Objectives

At the start of each lesson, there is a list of **Objectives** that clearly define the key points for mastery of the topic. They not only help you focus your reading, but also help you check for understanding.

"Summing Up This Lesson"

This boxed feature appears at the end of each lesson. It provides you with a summary of the main points covered in the lesson. Used together, the lesson summaries provide a comprehensive overview of the course content.

Sidebar Features

Sidebar features appear in the outer margins (left and right) of the text. These boxed features emphasize important points presented in the lesson, or provide additional, related information. Person-to-Person highlights opportunities for taxpavers. **Tax Tips** provide special tax information, such as exceptions to rules, infrequent but important considerations, or special tax cases. Potential Pitfalls point out commonly made errors and indicate ways to avoid these errors. Common Queries identify questions and issues that taxpayers often have, and help you respond to their concerns. Special Populations provides information pertaining to certain types of taxpayers, such as seniors, the non-English speaking, or the military. Alert! identifies pending legislation, tax law changes, or tax forms changes that were expected, but not enacted or in final form when this publication went to print. As a volunteer please confirm that you have the latest information on the tax law and forms before assisting your clients.

CONFIDENTIALITY AND INTEGRITY

Taxpayers come to you for help. To provide appropriate assistance, you will be asking very personal questions about the taxpayers and their families, their sources of income, and their expenses. Taxpayers will give this information only if they trust and have confidence in you. To maintain the taxpayer's trust and confidence, DO NOT disclose any personal tax information you learn as a result of the assistance you provide.

Taxpayers can be amazingly frank about their personal lives. When taxpayers share extremely personal information with you, this creates a responsibility for you not to discuss the information with other taxpayers or fellow volunteers. Never use a taxpayer's name in the presence of other taxpayers.

However, volunteers may discuss tax situations with other taxpayers and volunteers. For example, a volunteer may refer to a situation (not a taxpayer) and ask or give advice about the appropriate tax treatment for that specific situation.

The VITA and TCE Programs offer free tax assistance. You cannot accept payment nor any type of gratuity for preparing a federal tax return or for other tax-related assistance that you provide. If you accept payment for preparing a tax return, you are considered a "paid preparer." Paid preparers are legally liable under federal law for the returns they prepare; volunteers are not.

An important aspect of integrity for volunteer assistors is declining to prepare a tax return when there is a question about the validity of the information supplied by a taxpayer. Some individuals may attempt to defraud the government by filing false tax returns.

Volunteers who are not comfortable with the information provided by a taxpayer because of any reason, should discuss their concerns with their Site Coordinator or other individual in charge of the site.

QUALITY SERVICE

The goal of the TCE and VITA Programs is to provide high quality service. The following list suggests some ways to ensure that each return is prepared correctly:

- Use a calculator to check your math.
- Refer to your Publication 17, other IRS publications and job aids for help with complicated topics.
- Use the checklists and worksheets provided.
- Consult with other, more experienced, volunteers.
- Call the Volunteer Hotline (described later in this lesson).

Common Queries

Ask your instructor or IRS Territory Manager for the dates of operation and schedule of hours for the hotline.

Volunteer Hotline

There is a toll-free hotline available for VITA and TCE volunteer use only. This hotline is a source of tax information for volunteers. When you use the hotline, identify yourself as a VITA or TCE volunteer.

The hotline number is 1–800–829–8482 (829–VITA). **Do not give this number to taxpayers.** This service is generally available between February 1 and April 15th.

Do not use this hotline to order forms or schedules. Instead, contact your IRS Territory Manager.

Effective Interviewing

To complete accurate returns, you must ask certain questions about the taxpayers and their families. It is important to set the appropriate climate to obtain this information.

It is also important to be sensitive to the needs of all taxpayers you assist, especially those with disabilities. All references to taxpayers with disabilities should reflect the individuality, equality and dignity of the person.

Refrain from using such terms as "handicapped, physically or mentally challenged, differently challenged". It would be better to use:

Person(s) with a disability;

Persons who are blind; persons who are visually impaired; Persons who are deaf; persons who are hearing impaired or hard of hearing;

Persons who use a wheelchair;

Persons who are physically disabled; or, persons with mental retardation.

Steps to Effective Interviewing:

- 1. Make necessary introductions and engage in small talk.
- 2. Preface what will take place during the interview.
- **3.** Share your intentions and any hopeful results/benefits for the taxpayer.
- **4.** Allow the taxpayer to share any expectations, needs, and/or concerns.
- **5.** Respond with active listening skills.
 - A. Create a "safe" climate.
 - **B.** Remember your nonverbal listening clues.
 - **C.** Listen, then respond by:
 - 1. restating,

- 2. paraphrasing, (and/or)
- 3. encouraging.
- **6.** Ask the first key tax question, creating an awareness about why the tax information is needed.
 - **A.** Make no assumptions.
 - **B.** Ask no leading questions.
 - C. Ask, "What have you brought with you today?"
- **7.** Continue to ask questions. Define any terms that may be unfamiliar to the taxpayer.
- **8.** Check your own comfort level.
- **9.** Respond to any misunderstandings.
- **10.** Continue with effective questioning and active listening.
- 11. Overcome any communication barriers.
 - **A.** Stay on track. ("I hear you."/repeat question)
 - **B.** Allow adequate response time.
 - C. Avoid making assumptions.
 - **D.** Deal with taxpayers.
 - **1.** Silent ("Tell me more about . . .")
 - **2.** Upset (paraphrase)
 - E. Concentrate.
- **12.** Indicate the taxpayer's next steps. Educate the taxpayer about the VITA/TCE Programs and stress the benefits of accurate recordkeeping.
 - **A.** Express confidence in having completed an accurate tax return.
 - **B.** Part cordially.

What if . . . ?

Use these questions and answers to provide quick and accurate information to taxpayers who have administrative questions.

1. What is the CHIP Program?

The Children's Health Insurance Program (CHIP) is designed to help millions of children of working families obtain affordable and much-needed health insurance. CHIP informational materials are available at IRS Tax Assistance Centers and Volunteer Income Tax Assistance (VITA) sites. CHIP information (i.e. brochures, flyers) should be provided to VITA sites prior to the filing season. Volunteers at VITA site locations are not expected to answer any questions pertaining to this program, just to make information available to taxpayers visiting their sites.

2. How can I direct someone to their closest AARP sponsored Tax-Aide Site?

AARP Tax-Aide operates a toll-free nationwide number to help people find their closest Tax-Aide Site. The number is 1-888-227-7669. The information is also available on the AARP web page. The address is www.aarp.org/taxaide.

3. What if a taxpayer or dependent does not have a social security number?

Social security numbers are required for all taxpayers and dependents. Taxpayers who do not have a social security number must apply for one by using Form SS-5, *Application for a Social Security Card*. This form is available from the Social Security Administration and U.S. Citizens must show proof of age, identity, and citizenship when they apply for a social security number. Individuals who are age 18 or older must apply at the Social Security Administration office in person rather than by mail.

4. What if the taxpayer needs an IRS form or publication? Most IRS offices and many post offices and libraries have IRS forms that taxpayers may take or photocopy. They also have the instruction booklets for specific forms and publications. Remind the taxpayer that forms can also be ordered by calling the IRS on 1-800-829-3676 (1-800-TAX FORM) or from a fax machine dial (703) 487-4160.

IRS offers tax products and information on the Internet. The IRS Internet site provides instant access to federal income tax forms, instructions, publications, and information on free tax assistance programs, electronic tax filing, and more 24 hours a day. Current and prior year federal tax products and information are available for downloading.

By Internet:

- 1. World Wide Web www.irs.gov
- 2. FTP ftp.irs.ustreas.gov
- 3. Telnet iris.irs.ustreas.gov

5. What if the taxpayers move?

Taxpayers should use Form 8822, *Change of Address*, to notify the IRS of any change of address. If the taxpayers plan to move after sending the return and before a refund is received, they should notify their old post office and the IRS of their new address. (See item #4 for information on how to order Form 8822.)

6. Which address should taxpayers use, their street address or their post office box?

If the post office delivers mail to the post office box rather than to a street address, enter the P.O. box number on the line for the present home address.

7. What if the taxpayer needs a copy of a prior-year return?

To obtain a copy of a prior-year return, taxpayers should complete Form 4506, *Request for Copy or Transcript of Tax Form*, and mail it, with the required fee, to the Internal Revenue service center where the return was filed. As an alternative, a transcript of a prior-year return may be obtained, also using Form 4506. There is no charge for the transcript. A transcript shows most line items from the original return, including accompanying forms and schedules.

8. What if the taxpayer wants to make a voluntary contribution to reduce the public debt?

Voluntary contributions to reduce the public debt should be made payable to "Bureau of the Public Debt." The contribution may be sent in the tax return envelope. If the taxpayer is making a payment of tax due, as well as a contribution, there should be two checks or money orders in the tax-return envelope—one to pay the tax due and one to make the voluntary contribution. Voluntary contributions to reduce the public debt are considered charitable contributions and may be entered as an itemized deduction on Schedule A of Form 1040 in the year paid.

9. How long should taxpayers keep their tax returns?

Taxpayers should keep a copy of the tax return, worksheets used, and records of all items appearing on it (such as 1099 forms) until the statute of limitations runs out for that return. Usually, this is 3 years from the date the return was due or filed, or 2 years from the date the tax was paid, whichever is later. They should keep forms W-2 until the Social Security Administration has recorded the earnings reflected on the forms. Keep property records (including those on a home) as long as they are needed to figure the basis of the original or replacement property. Closing statements for a home should be kept until the home is sold. Brokerage statements showing the purchase price of stock should be kept until the stock is sold. Also, contributions to nondeductible IRAs should be kept until all IRA funds are withdrawn. Calculations determining the nontaxable portion of pension income should be kept until all of the pension income is taxable. For additional recordkeeping information, see Publication 552, Recordkeeping for Individuals.

10. What is On-Line filing?

On-line filing allows a taxpayer to file their tax return from home through an Internet Web site or third-party transmitter. Information about filing from home is included in many commercial tax preparation software packages. Also, many software companies offer tax preparation and electronic filing software that can be downloaded from the Web; or they provide the option for individuals to prepare their returns while logged on to the Internet.

All that is needed is a personal computer (PC), software and a modem to send the return data. On-line filing accommodates the same basic forms and schedules as electronic filing. The taxpayer is responsible for sending their signature document (Form 8453-OL) accompanying paper documents to IRS after they receive notification from the Internet on-line provider or transmitter that their return has been accepted by IRS. If IRS rejects the return, the taxpayer will either have to correct the information and retransmit the return or print it and send it as a paper return to IRS. Credit card and direct debit payment options are available for balance due returns.

11. Are there any publications or forms that can assist a taxpayer that owes prior year taxes or previously had their refund offset to satisfy another's debt?

IRS offers various publications and forms that are specific to these issues.

The IRS Collection Process, Publication 594, explains a taxpayers right and responsibility regarding payment of federal taxes. Installment Agreement Request, Form 9465, gives the taxpayer the option to pay a balance due through monthly installment payments.

Innocent Spouse Relief, Publication 971, addresses how one spouse may request relief from past taxes due solely based on the other spouse's debt. Request for Innocent Spouse Relief, Form 8857, explains various forms of relief and who may qualify.

Injured Spouse Claim and Allocation, Form 8379, allows a taxpayer to request relief from their spouse's past due federal debts including back child support and past due taxes. An injured spouse can get a refund for his or her share of the overpayment that would be used to pay the past due amount.

Additional information on these topics can be obtained by contacting the IRS at 1-800-829-1040, accessing their web page at www.irs.gov, or by visiting a Tax Assistance Center in your area.

WHERE IS THE TOPIC?

The following pages show forms 1040EZ, 1040A, and 1040. For a discussion about what to put on a line, turn to the lesson in this text that is shown in the circle.

Form 1040EZ

Form 1040EZ			Department of the Treas Income Tax F Joint Filers W	Return for S	ingle		2002		OM	IB No. 1545-0675	
Label)	our first name and initial		Last nar	me	7		Your social sec	urity number	
(See page 12.)	L A B E	ŀ	f a joint return, spouse's fir	st name and initial	Last nar	me			Spouse's social security number		
label. Otherwise, please print	L H E	F	Home address (number and	street). If you have a	P.O. box, s	ee page 12.		Apt. no.	▲ Impo	rtant! ▲	
or type.	City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.					You must enter your SSN(s) above.					
Election Campaign (page 12)	_		ote. Checking "Yes"						You □Yes □No	Spouse Yes No	
Income		1	Total wages, salarie form(s). Attach you		should l	be shown in	oox 1 of your W-2		1 (3)		
Attach Form(s) W-2	_	2	Taxable interest. If		\$400 vc	au cannot use	Form 1040FZ		2 3		
here. Enclose, but do not attach,	_	3	Unemployment cor (see page 14).			4			3 3		
any payment.		4	Add lines 1, 2, and	3. This is your	adjusted	l gross incon	ne.		4		
Note. You must check Yes or No.		5	Yes. Enter amou worksheet of	nt from	No.	If single, en If married,			5 (5)		
		6	Subtract line 5 from This is your taxable		5 is large	er than line 4	, enter -0	>	6		
Payments and tax	_	7	Federal income tax	withheld from l	oox 2 of	your W-2 for	m(s).		7 7		
	_	8	Earned income cr	edit (EIC).					8 (10)		
		9	Add lines 7 and 8.	These are your	total pay	ments.		>	9 (7)		
	1	0	Tax. Use the amou 24–28 of the bookl			•		pages	10 5		
Refund	1	1a	If line 9 is larger the	han line 10, subt	ract line	10 from line	9. This is your re	fund.	11a (7)		
Have it directly deposited! See page 20 and fill in	>	b	Routing number			> c	Type: Checkin	ng Savings		7	
11b, 11c, and 11d.	1	_	Account number If line 10 is larger	than line 0, subtr	not line (O from line 10) This is				
Amount you owe		2	the amount you ov	,				>	12		
Third party		•	ou want to allow and	other person to o	discuss th		the IRS (see page	· —	. Complete the f	ollowing. \square No	
designee	n	ame				Phone no. ▶ ()	Personal ider number (PIN)	▶		
Sign here Joint return? See page 11.	a o	Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge. Your signature Date Your occupation Daytime phone number ()									
Keep a copy for your records.	S	pou	se's signature. If a joint	return, both must	sign.	Date	Spouse's occupati	ion			
Paid preparer's			arer's ture	7				Check if self-employed	Preparer's SS	N or PTIN	
use only	y	ours	s name (or if self-employed), ess, and ZIP code					EIN Phone no.	()		
For Disclosure	, Pı	riva	acy Act, and Pape	rwork Reducti	on Act	Notice, see	page 23.	Cat. No. 11329W	7 Form 1	040EZ (2002)	

Form 1040EZ

Form 1040EZ (2002) Page 2

Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had **only** wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. But if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you cannot use this form, use TeleTax topic 352 (see page 6).

Filling in your return

For tips on how to avoid common mistakes, see page 30.

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can cla

aim	you as a dependent, u	use TeleTax topic 354 (see page 6).	
Α.	Amount, if any, from li	ine 1 on front	

+ 250.0<u>0</u> Enter total ► **A**.__

B. Minimum standard deduction

D. Maximum standard deduction. If **single**, enter \$4,700; if **married**,

E. Enter the **smaller** of line C or line D here. This is your standard

F. Exemption amount.

- If single, enter -0-.
- If married and—
 - —both you and your spouse can be claimed as dependents, enter -0-.
 - —only one of you can be claimed as a dependent, enter \$3,000.

G. Add lines E and F. Enter the total here and on line 5 on the front . . G._ If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a

dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by April 15, 2003. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



Form **1040EZ** (2002)

Form 1040A

Form 1040A	Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return (99) 2002 IR	S Use Only—Do not write or staple in this space.
Label (See page 19.)	Your first name and initial Last name	OMB No. 1545-0085 Your social security number
Use the	If a joint return, spouse's first name and initial Last name	Spouse's social security number
IRS label. Otherwise, please print or type.	Home address (number and street). If you have a P.O. box, see page 20. City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.	Apt. no. A Important! A You must enter your
Presidential	Only, town or post office, state, and 2if code. If you have a foreign address, see page 20.	SSN(s) above.
Election Campaign (See page 20.)	Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if filing a joint return, want \$3 to go to this fund?	You Spouse Yes □No □Yes □No
Filing status 2	2 ☐ Married filing jointly (even if only one had income) 3 ☐ Married filing separately. Enter spouse's SSN above and enter this of	usehold (with qualifying person). (See page 21.) fying person is a child but not your dependent, child's name here.
Check only one box.		ng widow(er) with dependent child ouse died ►). (See page 22.)
Exemptions	6a Vourself. If your parent (or someone else) can claim you dependent on his or her tax return, do not che	as a No. of boxes checked on 6a and 6b
(2)	b Spouse c Dependents: (2) Dependent's social security number (3) Dependent relationship to	
If more than six dependents, see page 22.	(1) First name Last name you	page 23) did not live with you due to divorce or separation
		(see page 24) Dependents on 6c not
		entered above Add numbers
Income	d Total number of exemptions claimed.	on lines above
Attach Form(s) W-2	7 Wages, salaries, tips, etc. Attach Form(s) W-2.	3 7
here. Also attach Form(s)	 Taxable interest. Attach Schedule 1 if required. Tax-exempt interest. Do not include on line 8a. Ordinary dividends. Attach Schedule 1 if required. 	
1099-R if tax was withheld.	10 Capital gain distributions (see page 25).	3 10
If you did not get a W-2, see page 25.	11a IRA distributions. 14 11a 11b Taxable (see pag	amount
Enclose, but do not attach, any payment.	Pensions and annuities. 12b Taxable (see page)	e 26). 12b
	13 Unemployment compensation and Alaska Permanent Fund of 14a Social security benefits. 14a 14b Taxable (see page)	amount
	benefits. 14a (see pag 15 Add lines 7 through 14b (far right column). This is your total inc	
Adjusted gross	16Educator expenses (see page XX).1617IRA deduction (see page 28).17	4
income	 Student loan interest deduction (see page 31). Tuition and fees deduction (see page XX). Add lines 16 through 19. These are your total adjustments. 	
	21 Subtract line 20 from line 15. This is your adjusted gross incor	
For Disclosure, P		Cat. No. 11327A Form 1040A (2002)

Form 1040A

Form 1040A	(2002)		Page 2	
Tax,	22	Enter the amount from line 21 (adjusted gross income).		22	
credits,			_		
and	23a	Check	23a	(5)	
payments	b	If you are married filing separately and your spouse itemizes	23a L		
Standard			23b □		
Deduction for—	24	Enter your standard deduction (see left margin).		24	
People who checked any	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0)	25	
box on line	26	Multiply \$3,000 by the total number of exemptions claimed on line 6		26	
23a or 23b or who can be	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0)	0.7	
claimed as a dependent,	28	This is your taxable income . Tax, including any alternative minimum tax (see page 33).	5	27	
see page 33. • All others:	29	Credit for child and dependent care expenses		20	
Single,		Attach Schedule 2.			
\$4,700 Head of	30	Credit for the elderly or the disabled. Attach			
household,		Schedule 3.			
\$6,900 Married filing	31 32	Education credits. Attach Form 8863. 9 31 Retirement savings contributions credit. Attach			
jointly or Qualifying	32	Form 8880.			
widow(er),	33	Child tax credit (see page 36).		•	
\$7,850 Married	34	Adoption credit. Attach Form 8839. 6 34			
filing separately,	35	Add lines 29 through 34. These are your total credits.		35	
\$3,925	36 37	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0 Advance earned income credit payments from Form(s) W-2.	(10)	36	
	38	Add lines 36 and 37. This is your total tax.		37 38	
	39	Foderal income tax withhold from Forms W-2			
		and 1099.			
	40	2002 estimated tax payments and amount			
If you have a qualifying		applied from 2001 return. 40 Farned income credit (FIC) 41			
child, attach Schedule	41 42	Earned income credit (EIC). 41 Additional child tax credit. Attach Form 8812. 11) 42			
EIC.	43	Add lines 39 through 42. These are your total payments.	(7)▶	43	
Refund	44	If line 43 is more than line 38, subtract line 38 from line 43.			
Diverse	45	This is the amount you overpaid .	\bigcirc	44	
Direct deposit?		Amount of line 44 you want refunded to you.	// -	45a	
See page 47 and fill in	▶ b	Routing number	gs		
45b, 45c,	▶ d	Account 7			
and 45d.		number			
	46	Amount of line 44 you want applied to your 2003 estimated tax. 7 46			
Amount	47	Amount you owe. Subtract line 43 from line 38. For details on how			
you owe		to pay, see page 48.		47	
	48	Estimated tax penalty (see page 48). 48			
Third party	, [Do you want to allow another person to discuss this return with the IRS (see page 49)?	Yes.	Complete the following. No	
designee			Personal ider number (PIN)		
Sign	ι	Inder penalties of perjury, I declare that I have examined this return and accompanying schedules a	and statemen	ts, and to the best of my	
here	C	mowledge and belief, they are true, correct, and accurately list all amounts and sources of income I re of preparer (other than the taxpayer) is based on all information of which the preparer has any know		·	
Joint return? See page 20.	N Y	/our signature Date Your occupation		Daytime phone number	
Keep a copy	-	Spouse's signature. If a joint return, both must sign. Date Spouse's occupation		- (-	
Spouse's signature. If a joint return, both must sign. Date Spouse's occupation records.					
Paid Preparer's Date Check if Preparer's S					
preparer's	_ s	signature / Self-em	ployed		
use only	У	vours if self-employed),	EIN		
	a	address, and ZIP code	Phone no.	() Form 40404 (0000)	
		₩		Form 1040A (2002)	

1-14 Introduction and Administrative Guidelines

<u> 1040</u>	_	the year Jan. 1–Dec. 31, 2002, or other tax year be		, 2002, er	, ,	, 20		MB No. 1545-0074		
Label	_	ur first name and initial	Last name		9	-		cial security numb	ber	
See L			Last name)						
instructions A B	If a	joint return, spouse's first name and initial	Last name				Spouse	's social security n	umbe	
on page 19.) Use the IRS										
label. H	Но	me address (number and street). If you have	a P.O. box, see pa	ıge 19.	Apt. n	0.	A 1	mportant!		
Otherwise, please print R	L.							ou must enter		
or type.	Cit	y, town or post office, state, and ZIP code. I	f you have a foreig	address,	see page 19.			ur SSN(s) above.		
Presidential C	Ļ.						You	Spous		
Election Campaign		Note. Checking "Yes" will not change					☐Yes			
(See page 19.)	, [Do you, or your spouse if filing a joint	return, want \$3							
Filing Status	1 L	☐ Single		4 L				person). (See page	,	
i iiiig Otatus	2 [Married filing jointly (even if only on			the qualifying p		niia but i	not your dependent	t, eni	
Check only	3 L	Married filing separately. Enter spot and full name here. ▶	use's SSN above	5			h danar	adopt obild (voor		
one box.	/	and full flame field.		3 1	spouse died	. ,		n dependent child (year (See page 19.)		
	6a	Yourself. If your parent (or some	one else) can cla	m you as				No. of boxes		
Exemptions		return, do not check be					}	checked on 6a and 6b		
	b	Spouse	<u> </u>		<u>.</u>	/.	<u></u> J	No. of children		
(2)	c	Dependents:	(2) Depend		(3) Dependent's relationship to	(4) ✓ if quali		on 6c who: • lived with you _		
		(1) First name Last name	social security	number	you	credit (see pa		• did not live with		
If more than five			1					you due to divorce or separation		
dependents,						\vdash		(see page 20)		
see page 20.			- !					Dependents on 6c not entered above _		
			1 :			누片		Add numbers	_	
	d	Total number of avamentions alaimed	<u> </u>			Ш		on lines		
		Total number of exemptions claimed			<u> </u>	(3)	7	above ▶ -		
Income	7	Wages, salaries, tips, etc. Attach Forr			(3		8a			
	8a b	Taxable interest. Attach Schedule B i Tax-exempt interest. Do not include	•	3)i 8	<u> </u>	<i>.</i>				
Attach Forms W-2 and	9	Ordinary dividends. Attach Schedule				(3)	9			
W-2G here.	10	Taxable refunds, credits, or offsets of	•		· · · · · · · · · · · · · · · · · · ·		10 (3		
Also attach Form(s) 1099-R	11	Alimony received				· - / · ·	11			
if tax was	12	Business income or (loss). Attach Sch	nedule C or C-EZ			(3)	12			
withheld.	13	Capital gain or (loss). Attach Schedule	e D if required. If	not requ	ired, check here		13			
	14	Other gains or (losses). Attach Form	1797				14			
If you did not	15a	IRA distributions (14) 15a		b Tax	able amount (see	page 23)	15b			
get a W-2, see page 21.	16a	Pensions and annuities 16a		b Tax	able amount (see	page 23)	16b			
see page 21.	17	Rental real estate, royalties, partnership	ips, S corporatio	ns, trusts	, etc. Attach Sch	edule E	17			
Enclose, but do	18	Farm income or (loss). Attach Schedu	le F			(3)	18			
not attach, any payment. Also,	19	Unemployment compensation) · · · ; ·				19			
please use	20a	Social security benefits . 20a	/		able amount (see		20b	3		
Form 1040-V.	21 22	Other income. List type and amount (Add the amounts in the far right column					21)		
				4 2						
Adjusted	23 24	Educator expenses (see page xx) . IRA deduction (see page 27)		· 2						
Gross	25	Student loan interest deduction (see	\smile	4) <u>2</u>						
Income	26	Tuition and fees deduction (see page	• ,	· 2						
	27	Archer MSA deduction. Attach Form	•		7					
	28	Moving expenses. Attach Form 3903	/	4) 2	8					
	29	One-half of self-employment tax. Atta		· 2	9					
	30	Self-employed health insurance deduc		30)	0					
	31	Self-employed SEP, SIMPLE, and qua		. 3	1					
	32	Penalty on early withdrawal of saving	- ·	. 3	2					
	33a	Alimony paid b Recipient's SSN ▶	1 1	33	Ba					
	34	Add lines 23 through 33a					34		<u> </u>	
	35	Subtract line 34 from line 22. This is y	our adjusted or	oss inco	me	•	35		1	

Form 1040

orm 1040 (2002)			Page
Tay and	36	Amount from line 35 (adjusted gross income)	
Tax and	37a	Check if: ☐ You were 65 or older, ☐ Blind; ☐ Spouse was 65 or older, ☐ Blind.	
Credits		Add the number of boxes checked above and enter the total here	
Standard Deduction	b	If you are married filing separately and your spouse itemizes deductions, or (5)	
for—		you were a dual-status alien, see page 31 and check here	
People who	38	Itemized deductions (from Schedule A) or your standard deduction (see left margin) 38	
checked any box on line	39	Subtract line 38 from line 36	
37a or 37b or	40	If line 36 is \$103,000 or less, multiply \$3,000 by the total number of exemptions claimed on	
who can be claimed as a	70	line 6d. If line 36 is over \$103,000, see the worksheet on page 32	1
dependent,	41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter=0 ₅ (5)	
see page 31. All others:	42	Tax (see page 33). Check if any tax is from a Form(s) 8814 b Form 4972 .5	
Sinale.	43	Tax (see page 66). Oneok ii aliy tax is iioiii a 🗀 Toiiii(5) 5614	
\$4,700		Alternative minimum tax (See page 64). Attach 1 offir 6201.	
Head of	44	7.00 iii.cs 42 u.i.d 40	
nousehold, \$6,900	45	Total Tax Croam Amazin Communication	
Married filing	46	Credit for child and dependent care expenses. Attach Form 2441	
ointly or	47	Credit for the elderly or the disabled. Attach Schedule R	
Qualifying widow(er),	48	Education credits. Attach Form 8863	
57,850	49	Retirement savings contributions credit. Attach Form 8880 49	
Married	50	Child tax credit (see page XX)	
iling separately,	51	Adoption credit. Attach Form 8839	
3,925	52	Credits from: a Form 8396 b Form 8859 52	
	53	Other credits. Check applicable box(es): a Form 3800	
		b ☐ Form 8801 c ☐ Specify 53	
	54	Add lines 45 through 53. These are your total credits	
	55	Subtract line 54 from line 44. If line 54 is more than line 44, enter -0	
Nation of	56	Self-employment tax. Attach Schedule SE	
ther	57	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	
axes	58	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required 14 58	
	59	Advance earned income credit payments from Form(s) W-2	
	60	Household employment taxes. Attach Schedule H	
	61	Add lines 55 through 60. This is your total tax	
ayments	62	Federal income tax withheld from Forms W-2 and 1099 (7) 62	
u yoo	63	2002 estimated tax payments and amount applied from 2001 return 63 (7)	
f you have a	64	Earned income credit (EIC)	
qualifying	65	Excess social security and tier 1 RRTA tax withheld (see page 51)	
child, attach Schedule EIC.	66	Additional child tax credit. Attach Form 8812	
scriedule Elo.	67	Additional child tax credit. Attach Form 6612	
		7 through paid with request for extension to the (600 page 61)	
	68 69	Other payments from: a Form 2439 b Form 4136 68 68 69 69 69 69 69 69 69 69 69 69 69 69 69	9
			+
efund	70	If line 69 is more than line 61, subtract line 61 from line 69. This is the amount you overpaid	+
rect deposit?	71a	Amount of line 70 you want refunded to you	
ee page 51 had fill in 71b.	► b	Routing number	
Ic, and 71d.	► d	Account number 7	
	72	Amount of line 70 you want applied to your 2003 estimated tax ▶ 72	4
mount	73	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52	
ou Owe	74	Estimated tax penalty (see page 52)	<u> </u>
hird Party	Do	you want to allow another person to discuss this return with the IRS (see page 53)? Yes. Comp	lete the following.
esignee	De	signee's Phone Personal identification	
	nar		<u> </u>
ign	Und bel	der penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the ief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which pi	e best of my knowledge ar
lere			
oint return?	Yo	ur signature 7 Date Your occupation Day	time phone number
ee page 19.)
eep a copy or your	Sp	ouse's signature. If a joint return, both must sign. Date Spouse's occupation	
ecords.	•		
)	Dro	eparer's Date Check if	parer's SSN or PTIN
aid		parer's Check if self-employed	
_		,	
reparer's	Fire	m's name (or	
reparer's Ise Only	you	m's name (or Lins if self-employed), dress, and ZIP code Phone no. (,

1-16 Introduction and Administrative Guidelines

TaxWise Hints

Each year the Internal Revenue Service contracts with a tax preparation software vendor to provide free software to our volunteers. This year you will find TaxWise hints integrated throughout the text. They will be at the end of each lesson just before "Summing Up This Lesson" or "Summing Up This Section".

▶▶ SUMMING UP THIS LESSON ◄◄

- ▶ Remember that the information used to prepare an individual's income tax return must be treated as confidential.
- ▶ Use the steps for effective interviewing.

STUI	DENT NOTES

Lesson 2

GETTING STARTED

OBJECTIVES

In this lesson you will learn what you need to know when you begin to prepare an individual's federal income tax return. Please note that two of the objectives concern the importance of insuring that the taxpayer's (or dependent's) name and social security number match our records.

After completing this lesson you should be able to:

- Explain the importance of requiring a social security card for the tax preparation.
- Identify the documents that could be used in-lieu-of a social security card.
- List the 5 tests for a qualifying dependent.
- List the requirements for each of the five filing statuses.
- Select the correct filing status.
- Determine Who Must File.
- Determine Who Should File.
- Select the appropriate tax form to use.

Social Security Number

Each year hundreds of thousands of returns are delayed in processing or credit/deductions disallowed because names and social security numbers do not match Social Security Administration (SSA) records. To prevent processing delays in paper returns and rejected electronically filed returns, volunteers must check the accuracy of each Social Security number, as well as the spelling of the name associated with the number.

To do this volunteers should ask for one of the following documents for each individual on the return.

- Social Security Card (original or copy)
- SSA 1099 benefit statements
- SSA letter

Tax Tips *******

The exemption amount is indexed for inflation and generally changes every year.

Note: Driver's licenses and passport may not depict the name or number as it appears on SSA records.

Personal and Dependency Exemptions

After completing this section, you will be able to:

- **Define** *personal exemption*.
- **Define** dependency exemption.
- **Use** the five tests to determine a qualifying dependent.

There are two kinds of exemptions: personal and dependency. While both exemptions are worth the same amount, different rules apply to each type.

Personal exemptions are allowed to the taxpayer and to the taxpayer's spouse.

Dependency exemptions are allowed to the taxpayer for qualifying dependents who meet five specific tests.

The taxpayer can usually deduct the **exemption amount** (\$3,000 for 2002) when figuring taxable income.

POTENTIAL PITFALLS

A common-law marriage is recognized for federal tax purposes if the marriage is recognized by the state where the taxpayers now live or in the state in which the common-law marriage was entered. Legal advice may be required to determine if a common-law marriage exists.

Personal Exemptions

The Taxpayer

The taxpayer can claim a personal exemption for himself or herself unless the taxpayer is eligible to be claimed as a dependent on another person's return. If this is true, the taxpayer cannot claim an exemption for himself or herself, even if the other taxpayer does not actually claim the dependency exemption.

The Spouse

Generally, if the taxpayer's spouse is claimed as a dependent on another person's return, the taxpayer cannot claim the spouse's exemption on his or her return. (One spouse is never considered the dependent of the other.)

To claim an exemption for a spouse, the taxpayers must be married by December 31, the last day of the year. If the taxpayer files a separate return, he or she can claim the exemption for his or her spouse only if his or her spouse had no gross income (defined later) and was not the dependent of another taxpayer. This is true even if the other taxpayer does not actually claim the taxpayer's spouse's exemption. If a taxpayer is divorced or legally separated at the end of the tax year, he or she cannot claim his or her (former) spouse's exemption.

If the taxpayer's spouse died during the year and the taxpayer did not remarry by December 31, the taxpayer can generally claim the personal exemption for the deceased spouse. This exemption can be claimed only if the taxpayer was not divorced or legally separated from his or her spouse on the date of the death and would have been able to claim the exemption under regular circumstances.

DEPENDENCY **E**XEMPTIONS

A **dependent** is a person, other than the taxpayer or spouse, who entitles the taxpayer to claim a dependency exemption. A taxpayer can claim a dependency exemption only if **all five** of the following dependency tests are met.

- 1. Member of Household or Relationship Test.
- 2. Citizen or Resident Test.
- 3. Joint Return Test.
- 4. Gross Income Test.
- **5.** Support Test.

1. The Member of Household or Relationship Test

To meet this test, the person must either:

- **A.** Live with the taxpayer for the entire year as a member of his or her household, or
- **B.** Be related to the taxpayer in one of the ways listed later, under *Relatives who do not have to live with the taxpayer*.

Note

A person away on temporary absences is considered to live and be a member of the household the entire year. Temporary absences include attending school, taking vacations, hospital stays due to illness, and military service. In addition, the relationship must not violate local law.

Relatives who do not have to live with the taxpayer

A person related to the taxpayer in any of the following ways does not have to live with the taxpayer the entire year as a member of his or her household to meet this test.

- Child, grandchild, great grandchild, etc. (A legally adopted child is considered the taxpayer's child.)
- Stepchild.
- Brother, sister, half brother, half sister, stepbrother, stepsister.
- Parent, grandparent, or other direct ancestor, but not foster parent.

Common Queries

A relationship established by marriage, such as "mother-in-law," does not end with divorce or the death of one of the spouses.

ALERT



Parents of children who are presumed to have been kidnapped by someone who is not a family member may be able to take the child into account in determining their eligibility for the head of household or qualifying widow(er) filing status, deduction for dependents, child tax credit, and the earned income credit (EIC). For details, see Publication 501, Exemptions, Standard Deductions. and Filing Information or Publication 596, **Earned Income** Credit.

TAX TIPS

Foreign exchange
students generally
cannot be claimed
as dependents.

- Stepmother or stepfather.
- Brother or sister of your father or mother.
- Son or daughter of your brother or sister.
- Father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law.

If a child was born alive during the year and meets the dependency tests, the taxpayer can take the exemption, even if the child lived only for a moment. No exemption is allowed for a stillborn child. State or local laws determine if a child was born alive or stillborn.

A legally adopted child is considered to be the taxpayer's child. If an adoption is finalized and the child begins living with the taxpayer on or before December 31, member of the household test is met.

If a foster child has lived with the taxpayer for the entire year (except for temporary absences) and the taxpayer cares for the child as his or her own, the child is treated as the taxpayer's own child.

A person who died during the year and was a member of the taxpayer's household until death meets the member of household test.

A cousin must live with the taxpayer for the entire year (except for temporary absences) to meet the member of household test. A cousin *does not* meet the relationship test.

2. Citizen or Resident Test

To meet this test, a person must be for some part of the year:

- a U.S. citizen or resident, or
- a resident of Canada or Mexico.

Children usually are citizens or residents of the country of their parents. A child born in a foreign country can be recognized as a U.S. citizen for tax purposes if either parent is a U.S. citizen.

If a taxpayer (who is a U.S. citizen) legally adopts a child who is not a U.S. citizen or resident, and the other dependency tests are met, the taxpayer can take the exemption if the taxpayer's home is the child's main home and the child is a member of the household for the entire tax year.

3. Joint Return Test

To meet this test, generally, the taxpayer's dependent cannot file a joint return. However, the joint return test does not apply if a joint return is filed by the dependent and his or her spouse *merely as a claim for refund* and no tax liability would exist for either spouse on separate returns.

4. The Gross Income Test

A taxpayer cannot take an exemption for a person whose gross income equals or exceeds the **exemption amount.** The exemption amount for 2002 is \$3,000.

Gross income is all *taxable* income in the form of money, goods, property, and services. It includes all unemployment compensation and certain scholarships. It does not include welfare benefits or nontaxable social security benefits.

There are two exceptions to the gross income test. The gross income test does not apply if:

- The taxpayer's child is under 19 years of age at the end of the year, or
- The taxpayer's child is under 24 years of age at the end of the year and is a full-time student.

To be considered a student, the taxpayer's child must attend school full-time for some part of each of five calendar months of the year. The five months need not be consecutive in order to qualify. School generally does not include night schools, on-the-job training courses, or correspondence schools.

5. The Support Test

The support test requires that the taxpayer provide more than half of a person's total support for the entire year in order to claim that person as a dependent.

There are two exceptions to the support test:

- Multiple support, and
- Children of divorced or separated parents.

 $(Both\ of\ these\ exceptions\ will\ be\ covered\ later\ in\ this\ section.)$

To determine if the taxpayer provided more than half of the dependent's support, compare the amount that the taxpayer contributed to the person's support with the entire amount of support the person received from all sources. (Exhibit 1 provides a worksheet for figuring whether the taxpayer provided more than half of a dependent's support.)

State benefit payments like welfare, food stamps, and housing are considered support provided by the state, not by the parent, regardless of how the parent actually spends the funds.

Support provided for the dependent includes support paid from these sources: amounts withdrawn from savings; borrowed amounts, such as student loans and car loans; and tax-exempt income, including social security benefits, life insurance proceeds, nontaxable pensions, gifts, and tax-exempt interest.

Only the amount of a dependent's own funds that is actually spent on support is counted. Scholarships received by full-time students are not included in total support.

Tax Tips *******

The gross income test exceptions do not apply to a son-in-law or daughter-in-law. The exceptions only apply to the *children* of a taxpayer.

Person

Person -

You will be asking very personal questions when trying to determine if the support test is met. As always, it is a good idea to explain to the taxpaver why you need to ask such personal questions. If the taxpayer becomes uncomfortable, explain that the information is necessary to help determine the correct tax liability.

TAX TIPS

When determining
who provides more
than half of the support, it is the dollar
amount of support
provided, not the
period of time the
support was provided, that counts.

TAX TIPS

The amount used to decide whether a person meets the support test is different from that used for the gross income test. The aross income test considers the dependent's taxable income only. The support test considers all income of the dependent, both taxable and nontaxable.

Tax Tips

Remind taxpayers
that they must maintain good records in
order to prove the
amount of support
provided.

Do not include in support any amounts that are:

- paid from a dependent's own funds for income and social security taxes,
- paid as life insurance premiums, or
- not spent, but saved or invested.

Total support items include food, clothing, shelter at fair rental value, education, medical and dental care, recreation, and transportation. Some support items, like food and rent, benefit more than one member of a household. Divide the value of these support items among the number of household members that benefit. Capital items like furniture, appliances, or autos should be included in support if the items are solely for the dependent's own use or benefit.

Example 1

Robin, age 20, lived all year with her parents and younger sister in an apartment. Robin earned \$4,000 from her part-time job. She saved \$1,000 for college and \$500 was withheld for income and social security taxes. Robin spent the remaining \$2,500 on clothing, transportation, and recreation.

Robin provided \$2,500 of her own support. The college savings will not be counted as support until the money is spent. The funds used to pay income and social security tax are not considered to be support.

In order for Robin's parents to claim her as a dependent, they must provide additional support of more than \$2,500. Included in support items are one-fourth of the family's rent, utilities, grocery bills, and any additional amounts paid for Robin's medical expenses and education.

Exhibit 1

Funds Belonging to the Person You Supported	
 Total funds belonging to the person you supported, including income received (taxable and nontaxable) and amounts borrowed during the year, plus the amount in savings and other accounts at the beginning of the year 	\$
2) Amount used for support	\$
3) Amount used for other purposes	\$
4) Amount in savings and other accounts at end of the year	\$
(The total of lines 2, 3, and 4 should equal line 1)	\$
Expenses for Entire Household (where the person you supported lived)	
5) Lodging (Complete item a or b)	
a) Rent paid	\$
b) If not rented, show fair rental value of home. If the person you supported owned the home, include this amount in line 19.	\$
6) Food	\$
7) Utilities (heat, light, water, etc. not included in line 5a or 5b)	\$
8) Repairs (not included in line 5a or 5b)	\$
 Other. Do not include expenses of maintaining home, such as mortgage interest, real estate taxes, and insurance. 	\$
10) Total household expenses (Add lines 5 through 9)	\$
11) Total number of persons who lived in household	
Expenses for the Person You Supported	
12) Each person's part of household expenses (line 10 divided by line 11)	\$
13) Clothing	\$
14) Education	\$
15) Medical, dental	\$
16) Travel, recreation	\$
17) Other (specify)	
	\$
18) Total cost of support for the year (Add lines 12 through 17)	\$
Did You Provide More Than Half?	
19) Amount the person provided for own support (line 2, plus line 5b if the person you supported owned the home)	\$
20) Amount others provided for the person's support. Include amounts provided by state, local, and other welfare societies or agencies. Do not include any amounts included on line 1.	\$
21) Amount you provided for the person's support (line 18 minus lines 19 and 20)	\$
22) 50% of line 18	\$

Is line 21 more than line 22?

Yes. You meet the support test for the person. If the other exemption tests are met, you may claim an exemption for the person. **No.** You do not meet the support test for the person. You cannot claim an exemption for the person unless you can do so under a multiple support agreement. See *Multiple Support*, later.

Lesson 2 2-7
BASIC

TAX TIPS ******* The taxpayers decide among themselves which one takes the exemption for the year. As a volunteer, you do not decide.

Multiple Support

Sometimes, no one person provides more than half of an individual's support, but two or more persons together do. In this situation, anyone who separately provides over 10 percent of the person's total support and meets the other tests can claim the exemption for the dependent. Nonetheless, only one person can claim the exemption. All other persons who provided more than 10 percent of the support and who meet the other tests must sign a written statement agreeing not to claim the exemption for that year. **Form 2120**, *Multiple Support Declaration*, is used for that purpose. The person who claims the exemption attaches Form(s) 2120 to his or her current year's tax return.

Example 2

Henry E. and Harold S. Rowan each provide more than 10 percent of the total support of their mother Margaret S. Rowan, but neither provides more than 50 percent. Together, Henry and Harold provide more than 50 percent. They decide that Henry will claim the exemption this year. Exhibit 2 shows the completed Form 2120 that Henry will attach to his return.

Exhibit 2 Henry's Form 2120

Form 2120 (Rev. October 2002)	Multiple Support Declaration	OMB No. 1545-0071		
Department of the Treasury Internal Revenue Service	► Attach to Form 1040 or Form 1040A.	Attachment Sequence No. 114		
Name(s) shown on return Henry E. Ro		our social security number		
During the calendar y	ear 2002 , the eligible persons listed below each paid over	10% of the support of:		
Margaret S. Ro	Wan Name of person supported			
I have a signed stated that began in the about	ment from each eligible person waiving his or her right to claim this person as a dep	endent for any tax year		
Harold S. Row	an	000:00:2780		
Eligible person's name				
	ot. no., city, state, and ZIP code)			
Eligible person's name		Social security number		
Address (number, street, ap	ot. no., city, state, and ZIP code)			
Eligible person's name		Social security number		
Address (number, street, ap	ot. no., city, state, and ZIP code)			
Eligible person's name		Social security number		
Address (number, street, ap	ot. no., city, state, and ZIP code)			

Children of Divorced or Separated Parents

The parent who has custody of the child for the greater part of the year (the custodial parent) will generally be considered as having provided over half of the child's support *if all of the following conditions are met*.

- The child received over half of his or her total support from one or both parents.
- The parents are divorced, legally separated, separated under a written separation agreement, or have lived apart at all times during the last six months of the calendar year.
- The child was in the custody of one or both parents for more than half of the calendar year.

The custodial parent *will not* be considered as having provided over half of the child's support if any of the following conditions exist.

- Over half of the support of the child is considered to have been received from a third party, such as a relative or friend.
- The custodial parent signed Form 8332, *Release of Claim to Exemption for Child of Divorced or Separated Parents*, or a similar statement, that allows the noncustodial parent to claim the exemption (this statement must be attached to the noncustodial parent's return).
- A decree or agreement that went into effect after 1984 unconditionally states that the noncustodial parent can claim the child as a dependent.
- A qualified pre-1985 agreement provides that the noncustodial parent shall be entitled to the exemption for the child and the noncustodial parent contributed at least \$600 toward the child's support during the tax year, unless the pre-1985 agreement is modified after 1984 to specify that this provision will not apply.

TAX TIPS

A copy of Forms 2120
and 8332 can be
found in the Tax
Forms Booklet
Appendix, which
is part of your
package.

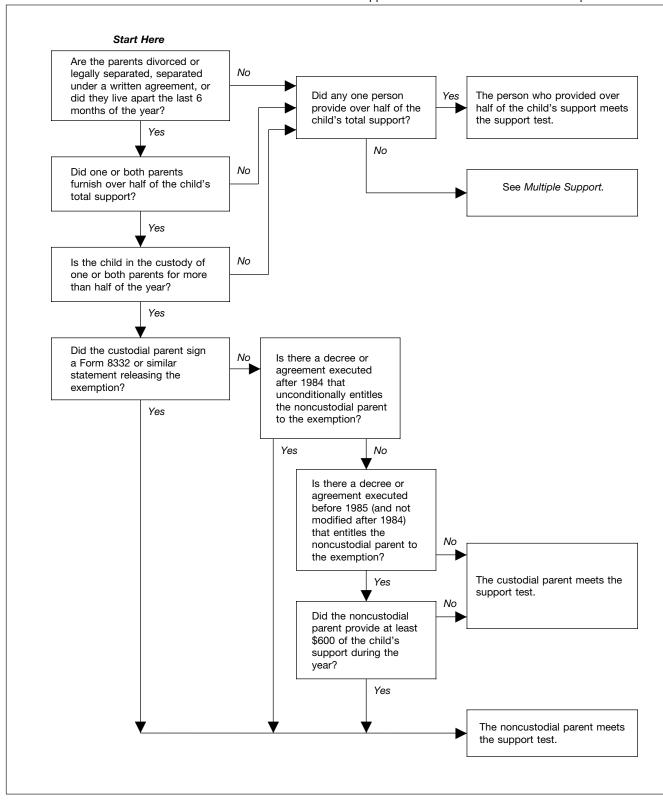
Example 3

Ellen M. and Richard A. Stone are divorced. Under the terms of the 1984 divorce, Richard has custody of their two children, Alan R. and Mary E. The divorce decree specifies that Ellen can claim the dependency exemptions. Ellen provided \$1,500 of support for each child. Assuming all other tests are met, Ellen can claim both children as dependents.

If Ellen had provided only \$500 of support for each child, she could not claim dependency exemptions for the two children. To claim the exemptions, she must provide at least \$600 of support for each child.

If the divorce occurred after 1984 and Richard and Ellen had agreed that Ellen would claim the dependency exemptions for the children, Ellen would attach Form 8332 or a similar statement to her tax return. Exhibit 3 shows a completed Form 8332 for Ellen.

Exhibit 3 Ellen's Form 8332 Form **8332 Release of Claim to Exemption** OMB No. 1545-0915 for Child of Divorced or Separated Parents (Rev. December 2000) ▶ Attach to noncustodial parent's return each year exemption is claimed. Attachment Department of the Treasury Internal Revenue Service Sequence No. 115 Caution: Do not use this form if you were never married. Name of noncustodial parent claiming exemption Noncustodial parent's social security number (SSN) 000 00 2338 Ellen M. Stone Release of Claim to Exemption for Current Year I agree not to claim an exemption for Alan R. Stone and Mary E. Stone Name(s) of child (or children) for the tax year 2002. Richard A. Stone 000 00 3823 3/26/2003 Signature of custodial parent releasing claim to exemption Custodial parent's SSN Note: If you choose not to claim an exemption for this child (or children) for future tax years, also complete Part II.



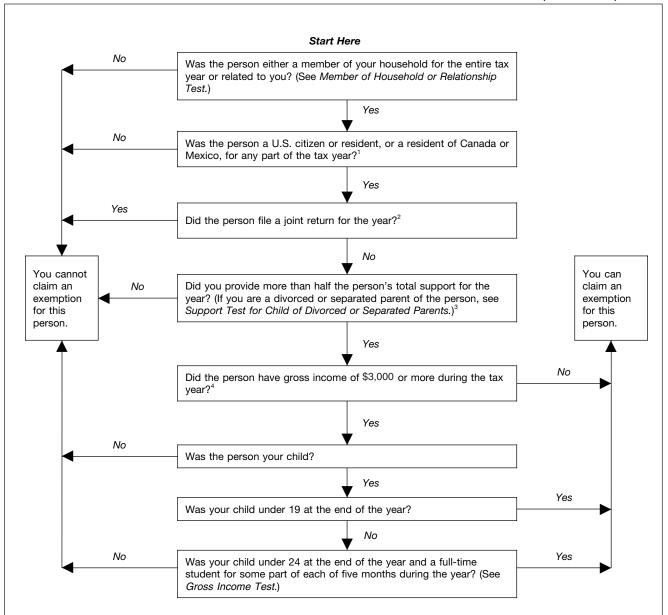
DETERMINING THE NUMBER OF EXEMPTIONS TO CLAIM

When determining the number of exemptions to claim, first look at the personal exemptions and then review each of the tests for dependency exemptions. There are many factors to consider as well as several major exceptions.

REMEMBER: Do not claim an exemption for a person who can be claimed on another return.

Exhibit 5

Can You Claim an Exemption for a Dependent?



¹If the person was your legally adopted child and lived in your home as a member of your household for the entire tax year, answer "yes" to this question.
²If neither the person nor the person's spouse is required to file a return, but they file a joint return only to claim a refund of tax withheld, answer "no" to this question.

³Answer "yes" to this question if you meet the multiple support requirements under Multiple Support Agreement.

⁴Gross income for this purpose does not include income received by a permanently disabled individual at a sheltered workshop.

Completing the Exemption Section of Forms 1040A and 1040

Exemptions are claimed on lines 6a through 6d. The taxpayer's personal exemption is claimed on line 6a. The personal exemption for the taxpayer's spouse is claimed on line 6b. The total of lines 6a and 6b is entered on the line in the right-hand margin. The dependency exemptions are claimed on line 6c. The columns on line 6c are self explanatory. In column 3, enter the specific relationship for each dependent: son, daughter, grandson, granddaughter, etc. Column 4 is checked if the taxpayer's dependent is also a qualifying child for the child tax credit (see lesson 11). The line 6c exemptions are totaled on the three right-hand-margin lines that relate to:

- Children who lived with the taxpayer,
- Children who did not live with the taxpayer due to divorce or separation, and
- Other dependents not entered on the lines above.

Line 6d shows the total number of exemptions (See Exhibit 6).

TAX TIPS

It is possible to
claim "0" exemptions if another person can claim the
taxpayer as a
dependent.

Exemptions	mptions 6a Vourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a. b V Spouse				No. of boxes checked on 6a and 6b	_2_
If more than six	c Dependents: (1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) Vif qualifying child for child tax credit (see page 23)	on 6c who: lived with you did not live	_1_
dependents, see page 22.	James Nicholson	000 00 3333	son		with you due to divorce or separation	
					(see page 24)	
					Dependents	
					on 6c not entered above	
• • • • • • • • • • • • • • • • • • • •			Add numbers on lines above	3		

TAX TIPS

Be sure to use the words "son," "daughter," "grandson," and "granddaughter" on line 6c, column 3. If you use the word "child," there may be a delay in processing the return.

TAXWISE HINTS

Tax law help is available at any point of tax preparation by pressing F1 for tax assistance.

When entering the information for each child click on the DC (Dependent Care) and the EIC (Earned Income Credit) boxes, if applicable, even if you are not sure if the taxpayer will qualify. The program will automatically determine the CTC (Child Tax Credit) based on data you put in the system. EIC will be correctly computed if the taxpayer qualifies.

TAX TIPS

Social Security
numbers are generally required for all
dependents. Failure
to enter the correct
social security
number may cause
the return to be
processed without
the benefit of the
dependency exemption. This may result
in increased tax or
decreased refund.

▶▶ SUMMING UP THIS SECTION ◀◀

There are two types of exemptions: personal and dependency. Each exemption reduces taxable income by \$3,000 in 2002.

A personal exemption can be claimed for a taxpayer and spouse if neither the taxpayer nor the spouse can be claimed on another taxpayer's return.

To claim a dependency exemption, the dependent must meet all of 5 tests.

- 1. The Member of Household or Relationship Test.
- 2. The Citizen or Resident Test.
- 3. The Joint Return Test.
- 4. The Gross Income Test.
- **5.** The Support Test.

There are two exceptions to the gross income test.

- ► Taxpayers' children under age 19.
- ► Taxpayers' children under age 24 who are full-time students.

There are two exceptions to the support test.

- ➤ The multiple-support agreement.
- Children of divorced or separated parents.

Exercises

- 1. Janice is 18 years old and a full-time student. She can be claimed as a dependent on her parents' tax return. Janice will file Form 1040EZ to report income from her summer job. How many personal exemptions can Janice claim on her return?
- **2.** Tom Brown supports his wife's uncle Jim (her mother's brother), who lives in another city. The Browns file a joint return. Can the Browns claim Jim as a dependent if all other tests are met?
- **3.** Ruth filed a joint return with her husband whom she married in November. They claimed two personal exemptions on their return. Ruth had no income; her husband had \$10,600 income. Can Ruth's father, who supported her and paid for the wedding, claim her as a dependent on his return?
- **4.** Joe is 65 years old and lives with his son and daughter-in-law. In 2002, Joe's taxable pension income was \$4,700. Can Joe's son and daughter-in-law claim a dependency exemption for Joe if all other tests are met?
- **5.** Randy's son, Paul, earned \$4,300 last year. Paul is 18 years old and started college in September 2002. Is the gross income test met?
- **6.** Traci's mother received \$3,500 in social security payments and \$600 in interest. Traci paid \$1,500 for her food and \$500 for her medical bills. Her mother paid \$2,400 for lodging, \$300 for recreation, \$150 for clothes, \$100 for transportation, \$400 for life insurance premiums, and \$200 for a television set.
 - **A.** What is the total support for Traci's mother? _____
 - **B.** How much did Traci contribute toward her mother's support?
 - C. How much did Traci's mother contribute toward her support?
 - **D.** Can Traci claim a dependency exemption for her mother?

- **7.** Mrs. Wood has three children, Mark, Tim, and Mary. Each child contributes toward Mrs. Wood's support. Mark provides 45 percent, Tim, 35 percent, and Mary, 10 percent.
 - **A.** Which, if any, of her children can claim a dependency exemption for Mrs. Wood under a multiple-support agreement?
 - **B.** If Mark is to claim the dependency exemption, who must sign a statement waiving his/her right to claim Mrs. Chase as a dependent? _____
- **8.** Under the terms of Peter's pre-1985 divorce decree, his former wife has custody of their child. The decree states that Peter can claim the exemption. He provided \$700 toward the child's support. Can he claim the exemption? ______

Exercise 1

0

Exercise 2

Yes; Jim is related by blood to Mrs. Brown.

Exercise 3

No, the husband has a filing requirement

Exercise 4

No; His gross income equals or exceeds the exemption amount of \$3,000.

Exercise 5

Yes; Paul is under the age of 19.

Exercise 6

- A. \$5,150 (\$1,500 + \$500 + \$2,400 + \$300 + \$150 + \$100 + \$200) Note that life insurance premiums are not considered support.
- B. \$2,000 (\$1,500 + \$500)
- C. \$3,150 (\$2,400 + \$300 + \$150 + \$100 + \$200) Note that life insurance premiums are not considered support.
- D. No; he did not provide more than half of her support.

Exercise 7

- A. Mark or Tim are eligible to claim the exemption. Both provide more than 10 percent of Mrs. Wood's support. Mary is not eligible since she does not provide more than 10 percent of the support.
- B. Only Tim must sign. Mary is not eligible to take the exemption. Therefore, she does not have to sign a waiver.

Exercise 8

Yes; Peter provided at least \$600 in support.

FILING STATUS

TAX TIPS

The Filing Status
section of Form
1040A and the Filing
Status section of
Form 1040 are
identical.

TAX TIPS

Remember that to file Form 1040EZ, the taxpayer (and spouse), must be under age 65 on 1/1/2003 and not blind at the end of 2002.

Tax Tips

If more than one filing status applies to the taxpayer, choose the one that will give the lowest tax.

SINGLE

A taxpayer is considered **single** if, on the last day of the year, either of the following is true.

- The taxpayer was never married.
- The taxpayer was legally separated, according to state law, under a decree of divorce or separate maintenance.

A taxpayer can also be considered **single** if the taxpayer was widowed before January 1, 2002, and did not remarry in 2002. However, the taxpayer may be able to use another filing status that will give a lower tax. See *Head of Household* and *Qualifying Widow(er) with Dependent Child*, later.

MARRIED FILING A JOINT RETURN

Taxpayers may use the **married filing jointly** status if they are married. They are considered married if, on the last day of the year, one of the following applies:

- They are married and live together as husband and wife.
- They live together in a common-law marriage recognized in the state where they now live or in the state where the common-law marriage began.
- They are married and live apart but are not legally separated under a decree of divorce or separate maintenance.
- They are separated under an interlocutory (not final) divorce decree.
- The taxpayer's spouse died during the year and the taxpayer has not remarried.

If taxpayers file a joint return, combine the husband's and wife's tax items (for example, income) on the same return. Both the husband and wife must sign the return and both are responsible for any tax owed on that return. Taxpayers can choose the married filing joint status even if only one spouse has income.

Taxpayers filing a joint return generally have a lower tax than their combined tax for any other filing status.

Married Filing a Separate Return

Taxpayers who are married may choose to file separately. The husband and wife report their own incomes and deductions on separate returns. Taxpayers may choose the **married filing separately** status even if one spouse had no income.

If the taxpayers live in a community property state, they must follow state law to determine their separate income. For more information, see Publication 555, *Community Property*.

If a married couple files separately and one spouse itemizes deductions, the other spouse must also itemize deductions because he or she cannot take the standard deduction. See Lesson 5 for more information on itemized deductions.

Taxpayers filing separate returns generally have a higher tax than when filing jointly. Occasionally, however, separate returns may result in a lower tax. If you think this might be the case, compute the tax liability for (a) married filing jointly and (b) married filing separately. Choose the filing status that results in the lower tax.

When a married taxpayer files separately, the taxpayer must show his or her spouse's name and social security number on the return.

HEAD OF HOUSEHOLD

In general, the **head of household** status is for unmarried taxpayers (or those considered unmarried) who pay more than half the cost of keeping up a home for a qualified relative during the year.

Generally, taxpayers who file under the **head of household** filing status have a lower tax than if they file as single. If they qualify, taxpayers should use the head of household status instead of the single status.

Head of Household Qualifications

1. The taxpayer must be unmarried (single, divorced, or legally separated) on the last day of the year

)R

The taxpayer must meet the tests for married persons living apart with dependent children (explained later in this lesson)

2. The taxpayer must have paid more than half the cost of keeping up a home that was the main home for more than half the year (except for temporary absences) of any of the following:

TAX TIPS

If a taxpayer is married, with a dependent child, and lived apart from the spouse during the last six months of the year, the taxpayer may be able to file as head of household. See the head of household requirements later in this lesson.

TAX TIPS

***** Some married couples do not want to file married filing jointly, even though it results in the lowest total tax. For example, one spouse may not want to be responsible for the other spouse's amount of tax owed. In such a case, the taxpayers may use the married filing separately filing status.

ALERT



For information on innocent spouse relief, see Publication 971, Innocent Spouse Relief.

Tax Tips

The head of household filing status
may be confusing.
Many filing status
errors involve the
head of household
status. Be sure
that ALL of the
qualifications are
met before selecting
the head of household status.

- **A.** The taxpayer's unmarried child—who must have lived with the taxpayer but does not have to have been the taxpayer's dependent,
- **B.** The taxpayer's foster child—who must have lived with the taxpayer and must have been the taxpayer's dependent (To qualify as a dependent, a foster child must live with the taxpayer for the entire tax year.), or
- **C.** Certain relatives (see the list at the end of this discussion) who lived with the taxpayer and who were the taxpayer's dependents.

EXCEPTION: The taxpayer may claim head of household filing status if the taxpayer's parent is claimed as a dependent, even if the parent does not live with the taxpayer. However, the taxpayer must pay more than half the cost of maintaining the parent's home for the entire year.

- **D.** The taxpayer's married child—who must have lived with the taxpayer and who must have been the taxpayer's dependent unless:
 - The child is not a dependent because the taxpayer signed a written declaration allowing the noncustodial parent to claim the child as a dependent, or
 - The child is not a dependent because the noncustodial parent provides at least \$600 of support for the child and claims the child as a dependent under a pre-1985 divorce decree or agreement.

"Child" includes:

■ Grandchild; stepchild; adopted child

"Relative" includes:

- Parent; grandparent
- Brother; sister; stepbrother; stepsister
- Half brother; half sister
- Stepmother; stepfather
- Mother-in-law; father-in-law
- Brother-in-law; sister-in-law
- Son-in-law; daughter-in-law

AND (if related by blood)

■ Uncle or aunt; nephew or niece

"Relative" does not include cousins and more distant relatives.

Keeping Up the Home

The taxpayer must pay more than half the cost of keeping up the home. The cost of keeping up a home includes: rent, mortgage interest, real estate taxes, insurance on the home, repairs, utilities, domestic help, and food eaten in the home. Welfare payments are not considered amounts that the taxpayer furnishes to keep up a home.

The home must have been the main home for more than half the year, except for temporary absences. Temporary absences include those for school, vacation, illness, business, or military service.

The following chart may help you decide who is eligible to claim head of household filing status.

Tax Tips *******

Taxpayers cannot claim the head of household status if they can only claim a dependent under a multiple support agreement.

Exhibit 7

Qualifying Relations for Head of Household			
Relationship to Taxpayer	Must Live with Taxpayer?	Must be Taxpayer's Dependent?	
1. Unmarried child, grandchild, or stepchild	Yes	No	
2. Married child, grandchild, or stepchild	Yes	Yes*	
3. Foster child	Yes***	Yes	
4. Mother or father	No	Yes	
5. Other relatives**	Yes	Yes	

Exceptions:

- *The married child does not have to be the taxpayer's dependent if a noncustodial parent claims the child as a dependent under the rules for children of divorced or separated parents.
- **Cousins and more distant relatives do not qualify as "relatives" in determining head of household status.

NOTE: The taxpayer's home must be the main home of the relative for more than half the year. The relative cannot be a person who files a joint return.

***The foster child must live with the taxpayer for the entire year.

TAX TIPS ******** Some married taxpayers qualify as head of household and do not know it. They think they must use the married filing separately filing status. You can be a big help to these taxpayers by advising them to use the head of house-

hold filing status to get the lower tax.

TAX TIPS

The IRS cannot process a head of household return unless a dependent's name is entered in the exemptions section or a nondependent's name is entered on the line next to the Head of Household filing the taxpayer's return.

AI FRT



Parents of children who are presumed to have been kidnapped by someone who is not a family member may be able to take the child into account in determining their eligibility for the head of household or qualifying widow(er) filing status, deduction for dependents, child tax credit, and the earned income credit (EIC). For details, see Publication 501, Exemptions, Standard Deductions, and Filing Information or Publication 596. Earned Income Credit.

Married Persons Living Apart With Dependent Children

Some married taxpayers who live apart from their spouses may be considered unmarried for tax purposes. If so, these taxpayers are permitted to file as head of household and receive the benefit of lower tax amounts.

A married taxpayer can file as head of household if:

- **1.** The taxpayer files a separate return,
- **2.** The taxpayer paid more than half the cost of keeping up his or her home for the year,
- **3.** The taxpayer's spouse did not live in the home during the last six months of the year,
- **4.** The taxpayer's home was the main home of the taxpayer's child, stepchild, or adopted child for more than half of the year or of the taxpayer's foster child for the entire year, and
- **5.** The taxpayer claims the child, stepchild, adopted child, or foster child as a dependent, unless one of the following exceptions for divorced or separated parents applies:
 - the taxpayer signed a statement allowing the noncustodial parent to claim the child as a dependent, or
 - the noncustodial parent provided at least \$600 for the child's support and can claim the dependent under a pre-1985 agreement.

Reporting Head of Household Filing Status

Taxpayers must enter the name of the person who qualifies them for the head of household status. If the person is a dependent, enter the dependent's name on line 6c of the exemption section of the tax return. If the qualifying person is not a dependent, enter the name of the nondependent person on line 4 in the filing status section of the tax return.

Example 4

Samantha is divorced and provided over half the cost of keeping up a home. Her five-year-old daughter, Pam, lived with her for seven months last year. Samantha does not claim Pam as a dependent; her ex-husband does.

Samantha may use head of household status. Samantha must write Pam's name in the space on Form 1040 or 1040A, on line 4.

Exhibit 8 Samantha's Form 1040A, page 1

Filing status

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶ 1 ☐ Qualifying person is a child but not your dependent, enter this child's name here. ▶ 1 ☐ Qualifying widow(er) with dependent child (year spouse died ▶). (See page 22.)

QUALIFYING WIDOW(ER) WITH DEPENDENT CHILD

A widow or widower, with one or more dependent children, may be able to use the **qualifying widow(er)** with dependent child filing status. This filing status yields the lowest tax (the same tax for married filing jointly).

If the taxpayer's spouse died during 2000 or 2001 and the taxpayer did not remarry before the end of 2002, the taxpayer may be able to file as a qualifying widow(er) with dependent child. To qualify, the taxpayer must:

■ Have been entitled to file a joint return for the year the spouse died (It does not matter whether or not a joint return was actually filed.),

AND

■ Have a child, foster child, adopted child, or stepchild who qualifies as the taxpayer's dependent for the year,

AND

■ Have furnished over half the cost of keeping up a home that was the main home of the child for the entire year.

An "adopted child" includes a child placed with the taxpayer by an authorized placement agency for legal adoption.

Social Security survivor benefits received on behalf of the child are considered to be amounts furnished by the child, not by the parent.

In the year a taxpayer's spouse dies, if the taxpayer does not remarry, he or she can use the married filing jointly filing status or married filing separately filing status and can claim an exemption for the deceased spouse. For two years after the year of death, the taxpayer may file as a qualifying widow(er) with dependent child, but may not claim an exemption for the deceased spouse. After the second year following the year of death, the taxpayer can no longer use the qualifying widow(er) filing status. The taxpayer may use either the head of household or single filing status depending on his or her situation then.

The following chart may help you decide which filing status to use for a taxpayer with a qualifying dependent if the spouse is deceased and the taxpayer has not remarried.

Person

TO.

Person \bigcirc

When seeking detailed information, be sensitive to the taxpayer's feelings. For example, talking about a deceased spouse may be very upsetting for a taxpayer regardless of how much time has passed since the death of his or her spouse.

Exhibit 9

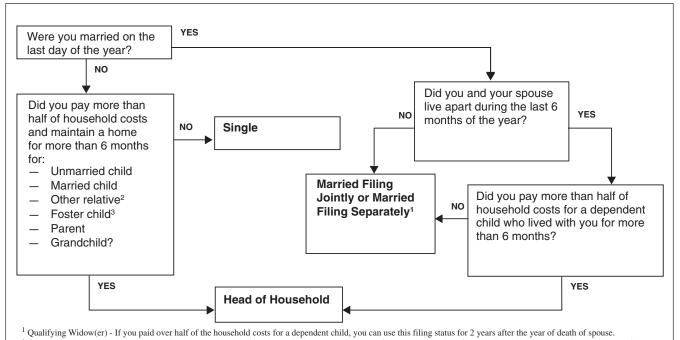
Filing Status After Death of Spouse			
Tax Year	Filing Status	Exemption for Deceased Spouse?	
1. Year of death	Married (joint) OR	Yes	
	Married (separate)	Yes	
2. First year after death	Qualifying widow(er)*	No	
3. Second year after death	Qualifying widow(er)*	No	
4. After the second year after death	Head of household** OR	No	
	Single	No	
*With a qualifying dependent.			
**With a qualifying relative.			

Taxpayers who use the qualifying widow(er) status must list the year of the spouse's death on line 5 of Form 1040A or 1040.

You may find the following flowchart helpful in determining the correct filing status.

Exhibit 10

Determination of Filing Status



² Parent, grandparent, brother, sister, stepbrother, stepsister, half brother, half sister, stepmother, stepfather, mother-in-law, father-in-law, brother-in-law, son-in-

law, daughter-in-law AND (if related by blood) uncle or aunt, nephew or niece. ³ The foster child must live with the taxpayer for the entire year and the taxpayer cares for the child as his or her own.

TAXWISE HINTS

When using TaxWise to prepare a tax return, you will need to have the Social Security Number of anyone who qualifies the taxpayer for Head of Household filing status and is not the taxpayer's dependent.

For Qualifying Widow(er) filing status, you must enter the year of death of the deceased spouse.

For Married Filing Separate status, you will need the spouse's full name and Social Security number.

►► SUMMING UP THIS SECTION ◀◀

When completing their tax returns, taxpayers can use one of five filing statuses:

Tax Status (from lowest tax to highest tax)

- 1. Married filing jointly*
- 2. Qualifying widow(er) with dependent child*
- 3. Head of household
- 4. Single
- 5. Married filing separately
- * Numbers 1 and 2 yield the same (lowest) tax.

Filing status is indicated on lines 1 through 5 of Forms 1040A and 1040. Selecting the correct filing status is one of the most important aspects of completing a tax return because the filing status factors in how much tax will be due. Remember that filing status requirements do not change, regardless of the tax form used. If a taxpayer is qualified to use more than one filing status, choose the one that will result in the lowest tax.

Exercises

9.	Carol and Roger were married in 2001. They are not
	divorced, but lived apart all of 2002. They are not legally
	separated under a decree of divorce or separate mainte-
	nance. They have no children. Can they use the married
	filing jointly status?

10.	Martin does not know which filing status to use. You ask if
	he is married. He answers that he got divorced in
	December but supported his wife all year and has not
	remarried. Can Martin and his ex-wife file a joint return?

11.	Ginger is single and paid more than half the cost of keep-
	ing up her home. Her grandmother lived with her all year.
	Ginger claims her grandmother as a dependent. What is
	Ginger's filing status?

- **12.** Bill is single and lives alone. He paid over half the cost of maintaining a home for his father for the entire year. He claims his father as a dependent. What is Bill's filing status?
- **13.** Franklin is single and lives alone. He paid over half the cost of maintaining a separate home for his father. He does not claim his father as a dependent. What is Franklin's filing status?
- 14. Mrs. Carmine tells you that she is divorced and that her 21-year-old unmarried son lived with her all year. She paid for their rent and food and provided over half of her son's total support. She cannot claim her son as a dependent because he earned \$4,000 and is not a student. Her son used his earnings to pay for his car, clothing, and entertainment. Can Mrs. Carmine file as head of household? ____
- **15.** Kathy lived with her unemployed roommate, Sandra, for the entire year. Kathy had to pay more than half of the cost of keeping up their apartment. Can Kathy file as head of household?

16. Jack has lived apart from his wife for several years. Their children live with his wife but Jack pays over half the children's support. What filing status can Jack use?

- 17. Lily left her husband in August 2002. She took her children with her. She supported the children during all of 2002 and will claim them as dependents. Lily will not file a joint return with her husband. Which filing status should Lily use in 2002?
- **18.** Rose and her husband separated in October 2002, but were still married on December 31, 2002. What filing status can she use?
- **19.** Dick's wife died in 2000. Dick has not remarried. Dick provides all of the support for his two dependent children. What will be Dick's filing status for 2003? _____

FILING STATUS Answers to Exercises

Exercise 9

Yes

Exercise 10

No

Exercise 11

Head of household

Exercise 12

Head of household

Exercise 13

Single

Exercise 14

Yes

Exercise 15

No; Sandra is not a qualifying relative.

Exercise 16

Married filing jointly or married filing separately.

Exercise 17

Married filing separately; she lived with her husband during part of the last six months of 2002.

Exercise 18

Either married filing jointly or married filing separately.

Exercise 19

Head of household; he could claim qualifying widower for 2001 and 2002 only.

Who Must File—Who Should File

Who Must File?

To decide who must file a tax return, you will need to know the individual's:

- filing status,
- age,
- gross income,

and if:

- special taxes might be owed on different types of income,
- some of the income is excludable or exempt,
- the individual can be claimed as a dependent on another's tax return,
- the individual is blind, or
- the individual received advance earned income credit payments.

You may not be familiar with some of the terms used on the list. These terms will be explained in later lessons. For now, concentrate on learning how to use the charts and checklists.

How to Use the Charts and Flowcharts

You will use a set of charts to determine who must file. An individual who cannot be claimed as a dependent on another tax-payer's return will use *Chart A—For Most People*. Based on the individual's circumstances, a person who can be claimed as a dependent on another taxpayer's return will use one of the other charts. *Chart C—Other Situations When You Must File* should be reviewed for every individual.

COMMON QUERIES

In the instructions to Forms 1040EZ, 1040A, and 1040, you will find charts that help determine who must file and who should file.

POTENTIAL PITFALLS



If a checklist or chart indicates that a person must file a return, he or she should do so even if no tax is owed. If a minor child must file a return but cannot do so, the child's parent or guardian must complete and sign a return for the child.

Exhibit 11

Chart A—For Most People			
If your filing status is	AND at the end of 2002 you were*	THEN file a return if your gross income** was at least	
Single	Under 65 65 or older	\$ 7,700 8,850	
Married filing jointly***	under 65 (both spouses) 65 or older (one spouse) 65 or older (both spouses)	\$13,850 14,750 15,650	
Married filing separately	Any age	\$ 3,000***	
Head of household (see page 19)	Under 65 65 or older	\$ 9,900 11,050	
Qualifying Widow(er) with dependent child (see page 19)	Under 65 65 or older	\$10,850 11,750	

^{*}If you turned age 65 on January 1, 2003, you are considered to be age 65 at the end of 2002.

^{**}Gross income means all income you received in the form of money, goods, property, and services that are not exempt from tax including any income from sources outside the United States (even if you may exclude part or all of it). **Do not** include social security benefits unless you are married filing a separate return and you lived with your spouse at any time in 2002.

^{***}If you did not live with your spouse at the end of 2002 (or on the date your spouse died) and your gross income was at least \$3,000, you must file a return regardless of your age.

Exhibit 12

Chart B—For Children and Other Dependents

If your parent (or someone else) can claim you as a dependent, use this chart to see if you must file a return.

In this chart, **unearned income** includes taxable interest and dividends. **Earned income** includes wages, tips, and taxable scholarship and fellowship grants.

If your gross income was \$3,000 or more, you usually cannot be claimed as a dependent unless you were under age 19 or a student under age 24. For details, see **Pub. 501**, Exemptions, Standard Deduction, and Filing Information.

Single dependents. Were you either age 65 or older or blind?

- □ **No.** You must file a return if **any** of the following apply.
 - Your **unearned income** was over \$750.
 - Your **earned income** was over \$4,700.
 - The total of your unearned and earned income was more than the larger of—
 - \$750, **or**
 - Your earned income (up to \$4,450) plus \$250.
- ☐ **Yes.** You must file a return if **any** of the following apply.
 - Your earned income was over \$5,850 (\$7,000 if 65 or older **and** blind).
 - Your unearned income was over \$1,900 (\$3,050 if 65 or older **and** blind).
 - Your gross income was more than—

The larger of:

- \$750, or
- Your earned income (up to \$4,450) plus \$250

PLUS This amount:

\$1,150 (\$2,300 if 65 or older **and** blind)

Married dependents. Were you either age 65 or older or blind?

- □ **No.** You must file a return if **any** of the following apply.
 - Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions.
 - Your unearned income was over \$750.
 - Your earned income was over \$3,925.
 - The total of your unearned and earned income was more than the larger of—
 - \$750, or
 - Your earned income (up to \$3,675) plus \$250.
- ☐ **Yes.** You must file a return if **any** of the following apply.
 - Your earned income was over \$4,825 (\$5,725 if 65 or older **and** blind).
 - Your unearned income was over \$1,650 (\$2,550 if 65 or older **and** blind).
 - Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions.

PLUS

• Your gross income was more than—

The larger of:

- \$750, **or**
- Your earned income (up to \$3,675) plus \$250

This amount:

\$900 (\$1,800 if 65 or older **and** blind)

Dependents Who Must or Should File A Return—Checklist

The dependents listed in the following checklist must or should file a return.

Exhibit 13

Checklist—Children and Other Dependents

- A married dependent with at least \$5 of income whose spouse itemizes deductions on a separate return on Form 1040 must file a return.
- A dependent with at least \$400 of net self-employment income must file a return. (**Self-employment income** is earned income from a trade, business, farming or profession that is not paid by an employer. For example, seamstresses and lawncare workers who work for themselves (and not for someone else) are considered self-employed.)
- A dependent who is not required to file but had income tax withheld should file a return to get a refund.
- A dependent who has to pay a tax, such as the alternative minimum tax, must file a return.

OTHER SITUATIONS

Remember to review the *Chart C—Other Situations When You Must File* chart after you use the other charts.

Exhibit 14

Chart C—Other Situations When You Must File

If any of the conditions below applied to you for 2002, you must file a return.

- 1. You owe any special taxes, such as:
 - Social security and Medicare tax on tips you did not report to your employer,
 - Uncollected social security and Medicare or RRTA tax on tips you reported to your employer or on group-term life insurance,
 - Alternative minimum tax,
 - Tax on a qualified retirement plan, including an individual retirement arrangement (IRA), or on an Archer medical savings account (Archer MSA), or
 - Recapture taxes. (See instructions for line 61 in the *Form 1040 Instructions* booklet).
- **2.** You received any advance earned income credit (EIC) payment from your employer. These payments should be shown in box 9 of your W-2 form.
- **3.** You had net earnings from self-employment of at least \$400.
- **4.** You had wages of \$108.28 or more from a church or qualified church-controlled organization that is exempt from employer social security and Medicare taxes.
- **5.** You had any gains from the sale of stock or bonds.

TAX TIPS

Do not become discouraged if you do not understand all of the terms used in the Other Situations
When You Must File chart. Some of the situations will be explained in later lessons. Generally, Other Situations go beyond the scope of the VITA/TCE
Program.

Who Should File a Return?

The charts, noted previously in this lesson, may indicate that an individual does not have to file a tax return. However, in three instances, individuals *should* file a return:

- to claim a refund of withheld taxes,
- to claim the earned income credit, and
- to claim the additional child tax credit.

HELPING THOSE WHO DON'T NEED TO FILE

The Reduce Unnecessary Filing Program (RUF) is intended to help certain individuals determine their need to file a federal income tax return. Use Form 9452, *Filing Assistance Program* Worksheet, to help potential unnecessary filers determine whether or not they need to file.

Thank you for helping to save time and effort for your VITA and TCE clients and for helping to reduce the cost to all taxpayers of processing unnecessary returns by helping your clients with Form 9452 and related materials, as needed.

Exhibit 15

	STUDENT NOTES
	STUDENTING
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▶▶ SUMMING UP THIS SECTION ◀◀

Use the charts provided in this section to determine who *must* and who *should* file a tax return.

Exercises

- **20.** Emily is married and has one dependent child. She has not lived with her husband since May and is head of household. She is under 65 and not blind. Her gross income from wages is \$15,000. Is she required to file a tax return?
- **21.** Larry and Zelda are married but will not file a joint return. Both are under 65 and not blind. Larry's gross income from wages is \$30,150. Zelda's gross income is \$3,500.

A. Is Larry required to file? _______ **B.** Is Zelda required to file? ______

TAX TIPS ***** If a taxpayer is not required to file a federal income tax return but still has federal income tax withheld, you should assist the taxpayer with completing a revised Form W-4, Employee's Withholding Allowance Certificate, or Form W-4P, Withholding Certificate for Pension or Annuity Payments.

Who Must File Who Should File Answers to Exercises

Exercise 20

Yes

Exercise 21

A. Yes

B. Yes

Which Form to Use?

FORM 1040EZ

Form 1040EZ is for single and joint filers with no dependents. The form is no longer designed to be read by an optical scanning machine. The form instructions booklet has a worksheet for tax-payers who can be claimed as dependents.

Form 1040A

Form 1040A is a two-page form. Page 1 of the form shows the filing status, exemptions, income, and adjusted gross income. Page 2 of the form shows the standard deduction, exemption amount, taxable income, tax, credits, payments, amount owed or refund, and signature. Form 1040A may have four schedules. Use Schedule 1 to report interest and/or dividend income that is more than \$400. Use Schedule 2 to report child and dependent care expenses and to figure the credit. Claim the credit for the elderly or the disabled on Schedule 3. This credit is explained in Lesson 15. If the taxpayer can take the earned income credit and has a qualifying child, use Schedule EIC to give information about that child. Schedule EIC is discussed and illustrated in Lesson 10.

Form 1040

Form 1040 is a two-page form. Page 1 of the form shows the filing status, exemptions, income, and adjusted gross income. Page 2 shows the standard deduction or itemized deductions, the exemption amount, taxable income, tax, credits, other taxes, payments, and the amount owed or refund due.

TAX TIPS

Forms 1040EZ,
1040A, and 1040 are
included in the *Tax*Forms Booklet
Appendix.

Tax Tips

Copies of many of
these forms and
schedules can be
found in the Tax
Forms Booklet
Appendix, which
is part of your
Publication 678
package.

TAX TIPS

If there is no entry
for a line, leave it
blank. You do not
have to enter zero on
lines that are not
used.

IRS E-FILE



IRS *e-file* offers quick and easy options to traditional paper returns. These options include filing electronically through an authorized tax practitioner, over the telephone, and by personal computer. For those expecting a refund, these options all offer Direct Deposit to a bank account. For those with a balance due, paying is made easier with the option of payment by credit card or a direct debit to their bank account.

Why *e-file?* Because IRS *e-file* makes filing faster and more accurate and gets the taxpayer their refund in half the usual time....even faster with Direct Deposit!

As a volunteer, you should become familiar with these options as there will be occasions when you are called upon to answer questions from taxpayers regarding one or more of them. You may even have the opportunity to volunteer at a VITA or TCE site that has been set up to offer electronic tax filing. If so, you will receive additional specialized training on using return preparation software and on other procedures unique to this type of site.

TeleFile

Eligible 1040EZ filers, single or married filing jointly, who receive a TeleFile tax booklet and have the same address as the previous year, can file their federal income taxes by using a touch tone telephone and dialing a toll-free telephone number found in the tax booklet. (Note: Taxpayers in Georgia, Indiana, Kentucky, Maryland, Oklahoma, Oregon, or West Virginia have the option to TeleFile both their federal **and** state tax returns in the same toll-free telephone call.)

Here's how it works: the taxpayer completes the TeleFile Tax Record found in the booklet before making the call. The call, which prompts the taxpayer through recorded instructions, takes less than ten minutes. The TeleFile system calculates the tax and refund (or balance due) and then files the tax return. If the taxpayer requests Direct Deposit, a refund can be issued in as little as 10 days. **TeleFile is completely paperless; no forms are mailed to IRS, not even W-2s!** The taxpayer "signs" the return with a special Customer Service Number (CSN) provided in the booklet.

TeleFile is available 24 hours a day, seven days a week, through August 15. It is also available to users of TDD/TTY equipment. Credit card and direct debit payment options are available for balance due returns.

Because TeleFile is so easy to use, and because it is completely paperless, its use should be encouraged at every VITA and TCE site that encounters an eligible taxpayer with a TeleFile tax booklet. Even if there is no touch tone telephone available at the site, you should do everything possible to convince the taxpayer to file from home, or wherever a touch tone phone is available.

INCOME LESSON 3

INTRODUCTION AND OBJECTIVES

In this lesson you will learn to distinguish between taxable and nontaxable income. You will also learn where to report the different types of income. In addition, you will learn to make income entries of Forms 1040EZ, 1040A, and 1040.

This lesson will help you achieve the following objectives.

- Calculate and properly report taxable income.
- Determine where capital gain distributions are reported.
- Determine who can use Schedule C-EZ.
- Accurately complete Schedule C-EZ and Schedule SE.

TAXABLE AND NONTAXABLE INCOME

Taxable income is any income that is subject to tax. It must be reported on a tax return, unless the amount is so small that the individual is not required to file a return.

The following types of income are taxable:

- Wages, salaries, bonuses, and commissions
- Certain fringe benefits
- Tips and other compensation for personal services
- Interest*
- Dividends
- Refunds of state and local taxes**
- Alimony received or separate maintenance payments received
- Business income
- Hobby income (a hobby loss is not deductible)
- Capital gains
- Gain from the sale of property
- Pensions and annuities (part may be nontaxable)
- IRA distributions (part or all may be nontaxable)
- Rents received
- Royalties
- Estate or trust income

POTENTIAL PITFALLS



Reimbursements for medical care are generally not taxable, but the reimbursement may reduce your medical expense deduction.

Likewise, you can get money tax free from your Archer medical savings account (Archer MSA) as long as you use the money to pay for qualified medical expenses. For more information see Publication 969, **Medical Savings** Accounts (MSAs) and Publication 502, Medical and Dental Expenses.

See also Lessons 4 and 5, later.

SPECIAL POPULATIONS



The Temporary Assistance for Needy Families program (TANF), replaced the Aid to Families with Dependent Children program (AFDC).

- Supplemental unemployment benefits
- Unemployment compensation
- Railroad retirement benefits (part may be taxable)
- Social security benefits (part may be taxable)
- Jury duty pay
- Executors' fees
- Gambling winnings (including lotteries, contests, raffles, etc.)
- Nonqualifying scholarships and fellowships
- Payments for punitive damages and damages not attributable to physical injuries or sickness
- Certain long-term care benefits. If the taxpayer received copy B of Form 1099-LTC, refer him or her to a paid professional preparer because some of the benefits may be taxable.

*Some interest is not taxable (for example, state and local bonds and qualified Series EE and Series I savings bonds used to pay for higher education expenses).

**Refunds of state and local taxes are taxable only if the taxpayer itemized deductions in the year the taxes were paid and the individual's tax liability was REDUCED because of the deduction.

Nontaxable income is income that is exempt from tax. If a return must be filed, some types of nontaxable income will be shown on the return but will not be added into the amount of income subject to tax.

The following types of income are nontaxable:

- Child support
- Federal income tax refunds
- Certain dividends on life insurance
- Gifts, bequests, and inheritances (may be subject to other taxes)
- Insurance and certain other payments for physical injury and sickness
- Interest on certain Series EE and Series I savings bonds redeemed to pay for qualified higher education expenses
- Interest on certain state and local obligations (municipal bonds)
- Most life insurance proceeds paid upon death (and certain accelerated death benefits or payments received under a life insurance contract on the life of a terminally or chronically ill individual before the individual's death)
- Public assistance payments (certain TANF payments)
- Certain railroad retirement benefits (part may be exempt)
- Social security benefits (part may be exempt)
- Veterans' disability benefits
- Workers' compensation
- Qualified scholarships and fellowships
- Certain dependent care services provided by employer
- Interest on insurance dividends left with VA
- Certain employer-provided educational benefits (up to \$5,250)
- Employer-provided assistance for qualifying adoption expenses. (Refer taxpayers with adoption expenses to a paid professional tax preparer and to Publication 968, *Tax Benefits for Adoption*)

- Restitution payments and excludable interest received by Holocaust victims, their heirs, or their estates, for persecutions are not taxable.
- Certain long-term care benefits. If the taxpayer received copy C of Form 1099-LTC, he or she is not the policyholder. The form is for information only and should be disregarded because none of the benefits are taxable to him or her. If the taxpayer received copy B of Form 1099-LTC, refer him or her to a paid professional preparer because some of the benefits may be taxable.

Example 1

LaDonna received the following income: wages, interest, child support, alimony, inheritance, workers' compensation, and lottery winnings.

The wages, interest, alimony, and lottery winnings are taxable income and will appear on LaDonna's tax return.

Child support, inheritance, and workers' compensation are non-taxable income and will not appear on LaDonna's tax return.

POTENTIAL PITFALLS



Form 1099-R reports pension income, not earned income.
Form 1099-R amounts are not included on line 7 of Form 1040.
They are reported on Form 1040A, lines 12a and 12b or Form 1040, lines 12a and 12b. You will learn how to report pensions in Lesson 14, Pensions.

Exercise 1 Indicate whether the income listed is taxable or nontaxable. Type of Income Nontaxable **Taxable** 1. Wages **2.** Dividends from stock **3.** Veterans' disability benefits **4.** Interest from savings account **5.** Credit union dividends **6.** Cash bonuses **7.** Inheritances 8. Tips **9.** Workers' compensation **10.** Veterans' life insurance dividends

POTENTIAL PITFALLS



Volunteers should be alert to the following possible indications of fraudulent activity:

- Forms W-2 that are typed, hand-written or have noticeable corrections
- Form W-2 from a firm in the area that is different from other W-2s issued by the same firm
- Suspicious person accompanying the taxpayer and observed on other occasions
- Multiple refunds directed to the same address or P.O. Box
- Employment or earnings, that are a basis for refundable credits, that are not well documented
- Similar returns
 (e.g. same
 amount of refund,
 or same number
 of dependents, or
 same number of
 W-2s)

Where to Report Income

Taxpayers can report only wages, salaries, tips, unemployment compensation, qualified state tuition program payments, Alaska Permanent Fund dividends, taxable scholarship and fellowship grants, and interest income of \$400 or less on Form 1040EZ.

In addition to the types of income that can be reported on Form 1040EZ, ordinary dividends, capital gains distribution interest income greater than \$400, IRA distributions, pension and annuity income, and taxable social security and equivalent railroad retirement benefits can be reported on Form 1040A.

These and all other types of income can be reported on Form 1040.

EARNED INCOME

Wages and Salaries

Total of wages, salaries, tips, and taxable scholarships and fellowships are reported on Form 1040EZ, line 1, Form 1040A or Form 1040, line 7.

Wages, salaries, and tips are primary examples of earned income received for services performed. Wages and salaries are compensation received. Tips are money and goods received as a gratuity by food servers, maids, porters, etc.

Form W-2. Form W-2, *Wages and Tax Statement*, reports the employee's earned income for the year. Employers should issue Form W-2 to every employee and a copy to the Social Security Administration. Box 1, *Wages, tips, and other compensation*, shows the amount of payments received in cash, goods and services, bonuses, supplemental unemployment benefits, awards, and taxable employee benefits. This amount should be included on the return.

An individual taxpayer or a couple filing jointly might have one or more W-2s from various employers. When the taxpayer and/or spouse receive W-2s from their employers, add the amounts from Box 1 of each W-2 and report the total amount on the return.

Generally, if a **household employee** earned less than \$1,300 a year while working in the employer's home, the employer is not required to provide the taxpayer with a Form W-2. However, a W-2 is required if the employer withheld federal income taxes.

If a taxpayer does not get a Form W-2, or if the one he or she gets is not correct, the taxpayer will have to contact his or her employer as soon as possible. Only an employer can **issue** a Form W-2 or a Form W-2c.

In the event that the employer prepared an incorrect W-2, a Form W2c, *Corrected Wage and Tax Statement*, should be issued. Use the W-2c amounts on the return. Be sure to attach the Form W-2c to the taxpayer's return.

All wage, salary, and tip income must be reported on the return, even if the employee did not receive a Form W-2.

If the taxpayer does not receive a Form W-2 by January 31, he or she should first contact the employer and find out if or when the Form W-2 was mailed. If after allowing a reasonable amount of time for the employer to issue or reissue the Form W-2, the Form W-2 still has not been received, he or she should contact the IRS for assistance at 1-800-829-1040, but not before February 15.

If after requesting a Form W-2 from the employer the taxpayer does not receive it by the due date of the return, he or she should file a Form 4852, Substitute for Form W-2, Wage and Tax Statement or Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA's, Insurance Contracts, Etc.

The taxpayer should keep a copy of Form 4852 for his or her records and file a copy with the Social Security Administration to ensure proper social security credit.

Form 1099-MISC. Taxpayers with earnings reported on Form 1099-MISC may be considered self-employed. These amounts are reported on Schedule C-EZ or Schedule C. Net losses and profits are reported on line 12 of Form 1040. Self-employment income is discussed later in this lesson.

Tip Income

All tip income is taxable. Individuals who receive \$20 or more per month in tips while working one job must report their tip income to their employer. Tips that are reported to employers are included with wages on Form W-2, box 1. If the taxpayer received tip income of \$20 or more in a month and did not report all of those tips to the employer, he or she must report the social security and Medicare taxes on the unreported tips as additional tax on Form 1040. Form 4137, Social Security and Medicare Tax on Unreported Tip Income, should be used to compute and report the additional tax.

Individuals who receive *less than \$20 per month in tips* while working one job do not have to report their tip income to their employer. Additionally, noncash tips (for example, tickets or passes) do not have to be reported to the employer. Tips of less than \$20 per month or noncash tips are not subject to social security and Medicare taxes. However, this tip income is subject to federal income taxes and must be reported on line 7 of Form 1040 or Form 1040A, or line 1 of Form 1040EZ.

TAX TIPS

Some employers
misclassify workers
as independent contractors and report
their earnings on
Form 1099-MISC.
Taxpayers who
believe that they
have been misclassified should contact the IRS.

TAX TIPS

If the taxpayer fails
to report tip income
as required to the
employer, the taxpayer may be subject to a penalty
equal to 50% of the
social security and
Medicare taxes
owed on unreported
tips.

POTENTIAL PITFALLS



The following individuals cannot file Form 1040EZ or 1040A: they must file Form **1040**: (1) Individuals who received \$20 or more in tips in any month while working for one employer and who did not report the full amount to the employer. (These tips are subject to social security and Medicare tax.) (2) **Taxpayers** whose Form W-2 has an amount entered in box 8. Allocated tips, that they must report as income. For more information, see Publication 531, Reporting Tip Income.

Allocated tips are tips an employer assigns to an employee. They are in addition to the tips the employee reported to the employer. The taxpayer may have allocated tips if he or she worked in a restaurant, cocktail lounge, or similar business that must allocate tips to employees.

Allocated tips are shown separately in box 8 of Form W-2. They are not included in the amount in box 1. The taxpayer must report allocated tips on his or her tax return unless either of the following exceptions applies.

- 1) The taxpayer kept a daily tip record, or other evidence that is as credible and as reliable as a daily tip record, as required under rules explained earlier.
- 2) The taxpayer's tip record is incomplete, but it shows that his or her actual tips were more than the tips reported to his or her employer plus the allocated tips.

If either exception applies, report actual tips on the return. Do not report the allocated tips.

If the taxpayer is required to report allocated tips on the return, the amount on Form W-2, box 8, should be added to the amount in box 1. The total is reported on line 7 of Form 1040. Allocated tips cannot be reported on Form 1040EZ or 1040A, and are subject to social security and Medicare taxes.

Example 2

Fred works as a repairman during the week and as a barber on alternate Saturdays. His tips are less than \$20 in any month and he does not report them to his employer. The amounts from box 1 on his Forms W-2 show income of \$23,500 (repairman) and \$1,950 (barber). His unreported tip income was \$200.

Fred will report \$25,650 on Form 1040A, line 7. This is the total of his Form W-2, box 1 income and his unreported tip income (\$23,500 plus \$1,950 plus \$200).

If Fred reported his tip income to his employer, the tips would be included in box 1 of the Form W-2 that he received from the barbershop. The amount in box 1 of that Form W-2 would be \$2,150 (\$1,950 plus \$200). Fred would still enter \$25,650 on line 7 (\$23,500 plus \$2,150).

The taxpayer should keep a copy for his or her records and file a copy with the local Social Security Administration to ensure proper social security credit.

Scholarships and Fellowships

Some scholarships and fellowships may be partially taxable. If the taxpayer received a Form W-2 for the scholarship or fellowship, add the amount in box 1 to any other box 1 amounts. Enter the total on line 1, Form 1040EZ, or line 7, Form 1040A or 1040.

Even if the taxpayer did not receive a Form W-2 for the scholar-ship or fellowship, the taxable portion of the scholarship or fellowship must be reported. Add the taxable portion to other Form W-2, box 1 amounts and unreported tip income. Enter the total on line 7 (Form 1040 or 1040A) or line 1 (Form 1040EZ). Write "SCH" and the amount not reported on Form W-2 in the space to the left of line 7 or line 1, whichever applies.

COMMON QUERIES

To determine if any part of a scholarship or fellowship is taxable, see the instruction booklet for Form 1040A or Form 1040 and Publication 520 Scholarships and Fellowships.

Exercise 2

- **A.** Mandy worked two jobs. She was a quality inspector during the week and a bartender on the weekends. She reported all of her tip income (\$3,000) to her employer. Her Forms W-2, box 1, showed income of \$21,000 (quality inspector) and \$8,250 (bartender). What amount will Mandy report on her Form 1040A, line 7?
- **B.** Peter works as a food server in an expensive restaurant. He tells you that he did not report his tip income of \$18,100 to his employer. Can Peter file Form 1040A? ______
- **C.** Alex had several employers during the tax year. On February 3, 2003, he comes into the VITA site to have his return prepared. He tells you that he has not received the Form W-2 for XYZ Inc. What should you tell Alex?

Interest Income

Money earns interest when it:

- is deposited in accounts in banks, savings and loans, credit unions,
- is used to buy certificates of deposit or bonds, or
- is lent to another person or business.

Interest income is considered unearned income. Money, not a person, is working to earn the income.

POTENTIAL PITFALLS



Some savings and loans, credit unions, cooperative banks, and mutual savings banks call their distributions "dividends." These "dividends" are really interest and are reported as interest. True dividends are different and will be discussed later in this lesson.

TAXABLE INTEREST INCOME

Savings Accounts

Interest is reported in the year that it is credited to the taxpayer's account and is available for withdrawal by the taxpayer. The taxpayer should report all interest received during the year, even if the interest is not entered in the taxpayer's passbook.

U.S. Savings Bonds

Interest on U.S. savings bonds is earned in one of two ways.

- Some bonds are issued at a "discount" and the interest earned equals the increase in the bond's value over a period of time.
- Some bonds pay interest at stated intervals of time.

Series EE and Series I Bonds. Series EE bonds are the most common type. They are issued at a discount; this means that the purchase price is less than the face value (the amount shown on the bond). The interest is the difference between the purchase price and the amount received when the bonds are redeemed (cashed in).

Series I bonds were first offered in 1998. They are issued at face value with a maturity period of 30 years. Interest on these bonds is paid when the bond is redeemed.

Taxpayers can choose one of two ways to report interest income from these bonds.

- Report the increase in value when the bond is cashed in or when the bond matures, whichever is earlier.
- Report the increase in the bond's value each year.

Generally, taxpayers must use the same method for all Series EE and Series I bonds they own.

If a U.S. savings bond is issued in the names of co-owners, such as the taxpayer and child, or the taxpayer and spouse, interest on the bond is generally taxable to the co-owner who purchased the bond. To determine who is responsible for paying the tax on a bond see the table below.

Exhibit 1

Who Pays Tax on U.S. Savings Bond Interest			
IF	THEN tax on the bond interest must be paid by		
You use your funds to buy a bond in your name and the name of another person as co-owners.	You.		
You buy a bond in the name of another person, who is the sole owner of the bond.	The person for whom you bought the bond.		
You and another person buy a bond as co-owners, each contributing part of the purchase price.	Both you and the other co- owner, in proportion to the amount each paid for the bond.		
You and your spouse, who live in a community property state, buy a bond that is community property.	You and your spouse. If you file separate returns, both you and your spouse generally pay tax on one-half.		

Example 3

Barbara owns a \$500 U.S. Series EE savings bond. She paid \$250 for the bond. When the bond matures, Barbara will receive \$500. At the end of the first year, the bond was worth \$265.

Barbara can report interest income in one of two ways.

- She can report \$250 of interest income when the bond matures. This is the difference between the \$500 value at maturity and the \$250 she paid for the bond. Barbara would report interest income only once, at maturity.
- She can report \$15 of interest income at the end of the first year. This is the increase in value at the end of the year (\$265 minus \$250). Barbara would report interest income each year until maturity.

Excludable Interest on U.S. Savings Bonds. Taxpayers may be able to exclude from income all or part of the interest received from certain qualified U.S. savings bonds. The taxpayer must have paid for qualified higher education expenses the same year the bonds are cashed. The bonds must be either Series EE bonds issued after 1989 or Series I bonds in the taxpayer's name or, if married, the taxpayer's name or spouse's name. The individual in whose name the bonds were issued must be 24 years of age or older before the bonds were issued. The taxpayer cannot file married filing separately.

POTENTIAL PITFALLS



For purposes of the savings bond interest exclusion, qualified higher education expenses do not include:

- those that the taxpayer used to claim the Hope or lifetime learning credits, or
- distributions from Coverdell ESAs that the taxpayer excluded from income.
- those paid with scholarships and fellowship distributions that were excluded from income.
- those paid with any nontaxable payments received (other than gifts, bequests, or inheritances) such as veterans' educational assistance benefits, benefits under a qualified state tuition program, or tax-free employer-provided educational assistance.

The Hope and lifetime learning credits are discussed in Lesson 9. The Coverdell ESA is discussed later in this lesson. Qualified higher education expenses include tuition and fees paid to an eligible educational institution for the bond owner, the bond owner's spouse, or the bond owner's dependent for whom the bond owner claims an exemption. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education.

Qualified expenses include any **contribution** to a qualified state tuition program or to a Coverdell ESA. (For more information, get Publication 970, *Tax Benefits for Higher Education*).

Use Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989 (For Filers with Qualified Higher Education Expenses), to report the exclusion of interest income. The excludable amount is transferred from Form 8815 to Part I, line 3 of Schedule 1 (Form 1040A) or to Schedule B (Form 1040).

Series HH Bonds. The interest on these bonds is paid twice a year. Report the interest on these bonds in the year in which it is received.

Other U.S. Obligations. Interest on other U.S. obligations, such as U.S. Treasury notes and bonds, is fully taxable when received.

Savings Certificates, Money Market Certificates, and Other Deferred Interest Accounts

Interest that is paid at fixed intervals of one year or less is included in taxable income when it is received or when the tax-payer could receive it (that is, when it is credited to the account, even if it is not withdrawn) without paying a substantial penalty. If an account matures in one year or less and provides a single interest payment at maturity, include the interest in taxable income when the account matures and the interest is received.

Example 4

Duane has a six-month certificate of deposit (CD) that matures in January 2003. He will receive \$75 in interest income.

Duane will report the interest income on the certificate of deposit on his 2003 tax return. It matures in one year or less with a single interest payment at maturity.

Certificates of Deposit with Maturities of Over One Year If interest on a CD is deferred for more than one year, the tax-payer must include a part of the interest in income each year. The taxpayer should receive Form 1099-INT stating the amount to report.

Example 5

Deborah has a two-year CD that pays interest every three months. She bought the CD on March 1, 2002. It matures on February 29, 2004.

For 2002, Deborah reports the interest income earned from March through December. For 2003, she will report 12 months of interest. For 2004, she will report two months of interest.

Original Issue Discount. Long-term obligations that pay no interest before maturity are considered to be issued at a discount. **Original Issue Discount (OID)** is the amount by which the principal amount (redemption price at maturity) of a long-term debt instrument, such as a bond or note, exceeds its issue price. Taxpayers generally report a portion of the OID each year until the obligation matures.

Example 6

Roger purchased a \$1,000 U.S. Treasury Zero Coupon Bond for \$350. When the bond matures, Roger will receive \$1,000. He will receive no interest income until the bond matures many years later.

The difference between the redemption amount (\$1,000) and the issue price (\$350) is the OID (\$650). Each year until maturity, Roger must recognize part of the OID as taxable interest income.

Interest on Insurance Proceeds

Life insurance proceeds include interest. Taxpayers can receive life insurance policy benefits paid upon the death of the insured either in a lump sum or in installments. Generally, if the payments are received in installments, the portion that is interest must be included in the taxpayer's income. However, if the insured individual died before October 23, 1986, and was the taxpayer's spouse, the first \$1,000 of interest income received each year is not taxed if the payments are received in installments. This exclusion does not apply if proceeds are left on deposit with the insurance company and only interest is paid.

Life insurance dividends generally are not taxable. These dividends may be used to reduce life insurance premiums due, purchase additional paid-up insurance, or earn interest. In general, the interest earned on life insurance dividends is taxable when it is credited to the taxpayer's account.

Interest on insurance dividends that have been left on deposit with the Department of Veterans Affairs (VA) is *not* taxable. Do not include this interest in taxable income. Any open year return on which such interest was reported as taxable can be amended for a refund of the tax.

TAX TIPS

A taxpayer can claim either the Hope credit or lifetime learning credit, in the same year you take a tax-free withdrawal from a Coverdell ESA, provided that the distribution from your **Coverdell ESA are** not used for the same expenses for which a credit is claimed. For additional information on the Hope credit or the lifetime learning credit, see Lesson 9, Education Credits.

COVERDELL ESA

Generally, an individual can establish a Coverdell ESA for a child who is under age 18. Contributions to a Coverdell ESA are not deductible. Amounts in the ESA grow tax free until they are distributed. No tax is due on distributions if the beneficiary had qualified education expenses (such as tuition, books, equipment, and certain other expenses needed to enroll at or attend an eligible educational institution), that were at least as much as the distributions during the year.

If Form 1099-R shows "M" in box 7, the taxpayer has received a distribution from a Coverdell ESA. Ask the taxpayer/beneficiary whether the distribution was more than the amount spent on:

- tuition, fees, books, supplies, and equipment needed to enroll at or attend a qualified educational institution,
- a qualified tuition program, or
- room and board if the beneficiary is at least a half-time student at the educational institution.

If the amount of the distribution was not more than the amount spent in these ways, the entire distribution is tax free. Report it on Form 1040A, line 11a, and leave line 11b blank; or report it on Form 1040, line 15a, and leave line 15b blank.

Refer the taxpayer/beneficiary to a paid professional tax preparer if the distribution was more than the amount spent for the purposes described above. Part or all of the distribution is taxable and must be computed.

TAX-EXEMPT INTEREST

Certain types of interest are exempt from federal income tax. Bonds issued by the following entities generally pay **tax-exempt interest:**

- State and political subdivisions (county or city),
- District of Columbia, and
- $\hfill \blacksquare$ U.S. possessions and political subdivisions.

Examples of tax-exempt bonds are those issued by:

- Port authorities
- Toll-road commissions
- Utility service authorities
- Community redevelopment agencies
- Qualified volunteer fire departments
- Some mutual funds

Although tax-exempt interest is not taxable, the taxpayer must report all tax-exempt interest on Form 1040, 1040A or 1040EZ.

Form 1099-INT

Interest income is reported to the taxpayer on Form 1099-INT, *Interest Income*. A copy of Form 1099-INT is also sent to the IRS.

Box 1 shows taxable interest income from various institutions.

Some taxpayers withdraw funds from a time deposit before the maturity date of the account and, therefore, incur an interest penalty. The early withdrawal penalty is reported on Form 1099-INT in box 2. Report the total interest earned, shown in box 1 of Form 1099-INT, on line 8a of Form 1040. Do not subtract the penalty from the total interest. The early withdrawal penalty is an adjustment to income and is entered on line 32 of Form 1040.

Box 3 shows U.S. savings bond and Treasury obligations interest. Be sure to ask the taxpayer about this interest income. The amount shown on Form 1099-INT may be too high if the taxpayer was not the original owner of the bond or if the taxpayer has reported the interest income each year as it was earned.

Some Forms 1099-INT will have entries in box 4 indicating that federal income tax has been withheld from the interest paid. Be sure to include the amount shown in box 4 with other tax withheld on Form 1040A, line 39, or Form 1040, line 62.

Form 1099-0ID

Form 1099-OID, *Original Issue Discount*, reports the amount of Original Issue Discount income that a taxpayer should report as income for the year. A copy of Form 1099-OID is also sent to the IRS.

Box 1 shows the amount of interest (OID) for the year if the taxpayer bought the obligation at its original issue and held the issue all year.

Box 2 shows regular interest paid on the obligation other than the OID income.

Reporting Interest Income

If the taxpayer is a **1040EZ** filer, taxable interest income is reported on line 2. 1040EZ filers should report tax-exempt interest by writing "TEI" and the amount of tax exempt interest on line 2 as shown in the example below. Do not include tax-exempt interest in the *Dollars/Cents* portion of line 2. If the tax-payer's interest income is more than \$1500, he or she cannot file a Form 1040EZ.

TAX TIPS

A copy of a Form
1099-INT can be
found in the Tax
Forms Booklet
Appendix, which is
a part of your
Publication 678
Package.

TAX TIPS ***** Taxpayers must report the following types of interest income on Form 1040. These types of income cannot be reported on Form **1040EZ or 1040A**: (1) Original Issue Discount (OID) that is different from the amount reported on Form 1099-0ID: (2) accrued interest received or paid on securities transferred between payment dates, and (3) bond interest income reduced by amortizable bond

TAX TIPS

premium.

Some taxpayers
will receive a
mutual fund statement which shows
tax-exempt interest.
Be sure to include
the tax-exempt
interest on the
return.

Example 7

Jennifer received taxable interest income of \$65 and tax-exempt interest income of \$23. She would report her interest income as shown in the exhibit below.

Exhibit 2		Jennifer's 1040EZ
Income	1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	
Attach Form(s) W-2 here.	2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ. TEI=\$23.00 2	6500
Enclose, but do not attach,	3 Unemployment compensation, qualified state tuition program earnings, and Alaska Permanent Fund dividends (see page 14).	
any payment.	4 Add lines 1, 2, and 3. This is your adjusted gross income. 4	
Note. You	5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from No. If single, enter 7,450.00.	

TAX TIPS

F. J. 11, 14, 0

Taxpayers should not have received a Form 1099-INT for tax-exempt interest. But if they do, they must report it on Form 1040A, Schedule 1, line 1, or Form 1040, Schedule B, line 1.

TAX TIPS

Taxpayers must complete Schedule B,

Part III if they:

- had over \$1500 of interest or ordinary dividends
- had a foreign account, or
- received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

Taxpayers who file **Forms 1040A or 1040**, report taxable interest income on line 8a and tax-exempt interest on line 8b.

If the taxpayer files Forms 1040A or 1040 and:

- Has interest income of more than \$1500,
- Wants to claim an exclusion for savings bond interest in the same year that he or she paid for qualified higher education expenses, or
- Receives a Form 1099-INT for tax-exempt interest,

Schedule 1, Part I (1040A) or Schedule B, Part I (1040) must be completed, before making an entry on line 8a or 8b.

If the tax-exempt interest is shown on a Form 1099-INT, and a Schedule 1 or B must be filed, the taxpayer must include tax-exempt interest on Schedule 1 or B. It should be reported on line 1 but it should not be included in the total on line 2. Instead, under the last entry on line 1, a subtotal of all interest listed should be made. Below the subtotal, the taxpayer should write "Tax-exempt interest" and show the amount. Subtract it from the subtotal and the result should be entered on line 2.

On Schedule 1 or Schedule B, Part I, list the interest payers' names and the various amounts received for each form, even if there are two or more forms from the same source.

Exercise 3

- **A.** Randy and Ann have three Forms 1099-INT: Epping National Bank, \$62; Epping Credit Union, \$178; and Brenton Savings and Loan, \$760.
 - **1.** How much interest income will be reported on Schedule 1 (Form 1040A)?
 - **2.** How much interest income will be reported on Form 1040A, line 8a?
- **B.** Catherine received \$398 interest income this year. She files Form 1040EZ. How much interest income is reported on her return, and where is it reported?
- C. Emily and Andrew file a joint return on Form 1040. They have the following interest income: City Savings and Loan (joint), \$320; Third National Bank (Andrew), \$100; U.S. Series HH Savings Bonds (joint), \$45; and Welder's Credit Union (Emily), \$30.

How much interest is reported on their Form 1040, and where is it reported?

DIVIDEND INCOME AND OTHER CORPORATE DISTRIBUTIONS

Dividends are payments made by corporations to share-holders. Dividends can also be paid through partnerships, estates, or trusts.

There are several types of corporate distributions, including ordinary dividends, capital gain distributions, nontaxable distributions, stock dividends, and others. Most dividends are paid in cash. Some dividends, however, are paid in property, services, or additional shares of stock. Only **ordinary dividends** can be reported on Form 1040A. Any other dividends or distributions received are reported on Form 1040. Taxpayers with dividend income may not use Form 1040EZ. Other types of dividends and distributions include the following:

■ Dividend reinvestment — Through **dividend**reinvestment, instead of receiving cash (a dividend check),
some stockholders ask the corporation to use their dividends
to purchase more shares of the corporation's stock. The
shareholders "reinvest" their dividends. The dividend is taxable at the time it would be paid if it were in cash.

TAX TIPS ******** Credit union dividends are reported as interest.

TAX TIPS

A copy of a Form
1099-DIV is included in the Tax Forms
Booklet Appendix, which is a part of your Publication 678
Package.

TAX TIPS ******** Use ditto marks to save time when reporting more than one Form 1099-INT or Form 1099-DIV from the same financial institution or corporation.

- Capital gain distributions Mutual funds (regulated investment companies) and real estate investment trusts (REITs) pass capital gains to their investors in the form of **capital gain distributions.** Capital gain distributions are treated as long-term capital gains, regardless of how long the taxpayer holds the shares. See Lesson 12, *Sale of Stock*, for more information on capital gains.
- Return of capital A **return of capital** represents a return of part of the taxpayer's investment in the stock of the company. A return of capital reduces the basis of the stock and is not taxed until the taxpayer's basis in the stock is fully recovered. Any return of capital in excess of basis is treated as a capital gain and is reported on Schedule D, *Capital Gains and Losses*.
- Stock dividends **Stock dividends** increase the taxpayer's number of shares in the company. Generally, stock dividends are not taxable.

Other types of nontaxable dividends are:

- Exempt-interest dividends paid by mutual funds (This interest is listed on Form 1040, line 8b.)
- Dividends on insurance policies, as long as they do not exceed the total of all net premiums paid by the taxpayer
- Dividends on veterans' insurance
- Certain patronage dividends

Reporting Dividends and Capital Gain Distributions

The payer reports dividends and certain other distributions on **Form 1099-DIV,** *Dividends and Distributions*.

Ordinary dividends are reported in box 1 of Form 1099-DIV. Add the amounts in box 1 from all the Forms 1099-DIV the tax-payer received. If the total is:

- \$1500 or less, enter the total on line 9 of Form 1040A or 1040.
- over \$1500, complete Schedule 1 (Form 1040A), Part II, or Schedule B (Form 1040), Part II. Transfer the result to line 9 of Form 1040A or 1040.

On Schedule 1 or Schedule B enter the payer's name and the amount received for each Form 1099-DIV even if the same corporation used separate forms to report more than one distribution. If the taxpayer has a substitute Form 1099-DIV from a brokerage firm, it may show a total for dividends received. Enter the brokerage firm as the payer of the dividends and enter the total dividend amount. Do not list the dividends individually.

Some taxpayers receive dividend income from shares that the husband and wife own jointly. If they file a joint return, enter the total dividend in the appropriate place on the return. If they file separate tax returns, divide the dividend by two. Report half on the husband's return and half on the wife's return.

Capital gain distributions occur when a mutual fund (regulated investment company) sells assets for more than their cost, and the realized capital gain is distributed to the fund's shareholders. This should not be confused with a capital gain that occurs when the owner of a mutual fund or a capital asset sells shares in the fund or the asset for more than the cost and realizes a capital gain. For more information on capital gains and losses, see Lesson 12, *Sale of Stock*.

Payers report capital gain distributions in box 2a of Form 1099-DIV. Taxpayers can report capital gain distributions directly on Form 1040A or Form 1040 if:

- The only amounts the taxpayer has to report on Schedule D are capital gain distributions (box 2a),
- The taxpayer does not have any 28% rate gain (box 2b), qualified 5-year gain (box 2c) unrecaptured section 1250 gain (box 2d), or section 1202 gain (box 2e), and
- If the taxpayer files Form 4952, *Investment Interest Expense Deduction*, the amount on line 4e of Form 4952 is not more than zero.

If the taxpayer does not meet the requirements to report the capital gain distribution directly on Form 1040A or Form 1040, a Schedule D, *Capital Gains and Losses* must be filed. If a Schedule D is not required, the capital gain distributions can be reported directly on line 13 of Form 1040, or line 10 of Form 1040A. Capital gain distributions are not reported on Form 1040EZ.

If capital gain distributions are reported directly on Form 1040 or Form 1040A:

- Check the box next to line 13, Form 1040 and
- Use the Capital Gain Tax Worksheet from either the Form 1040A or 1040 instruction booklet to compute tax.

TAX TIPS

If the taxpayer has unrecaptured section 1250 gain from mutual funds or real estate investment trusts, or has section 1202 gains, or must file Form 4952, advise the taxpayer to consult a paid professional tax preparer.

The volunteer should be careful not to ignore other boxes on the Form 1099-DIV.

- Box 2c, *Qualified 5-year gain*. If the taxpayer has an entry in box 2c, see Lesson 12 for the proper treatment of the gain.
- Box 4, *Federal income tax withheld*. Be sure to include this amount on line 39 of Form 1040A or line 62 of Form 1040.
- Box 5, *Investment expenses*. If the taxpayer files Form 1040 and itemizes deductions on Schedule A, report the amount from box 5 as a miscellaneous itemized deduction subject to the 2%-of-adjusted-gross-income limit. (See *Itemized Deductions* in Lesson 5.)
- Box 6, *Foreign tax paid*. If the taxpayer has an entry in box 6, see Lesson 6 for the proper treatment of the tax. The taxpayer may be able to claim the Foreign Tax Credit.

A capital gain distribution is reported on a Schedule D when the taxpayer has more than capital gain distributions to report, for example when boxes 2b, 2d, 2e, 3, 8, or 9 have entries, or when the taxpayer has sold a capital asset. Capital gain distributions are always treated as long-term capital gains, regardless of how long the taxpayer holds the shares, and are reported on line 13, column (f) of the Schedule D. If the taxpayer has an entry in box 2b, then that number is reported on line 13 column (g).

STATE AND LOCAL TAX REFUNDS

Taxpayers who receive a refund of state or local taxes may receive a Form 1099-G, *Certain Government Payments*. If the taxpayer claimed the standard deduction on the 2001 return and received a refund of 2001 state or local tax, the taxpayer does not have to include the refund in taxable income. However, if the taxpayer itemized deductions **and** received a state or local tax refund, the taxpayer may have to include part or all of the refund in taxable income. Use the *State and Local Income Tax Refund Worksheet—Line 10* in the Form 1040 instruction booklet to determine what part, if any, of the refund is taxable. Enter the taxable portion of state and local refunds on Form 1040, line 10.

POTENTIAL PITFALLS



If the state or local income tax refund reflects any deductions, credits, or payments for years other than 2001, refer the taxpayer to a paid professional tax preparer.

ALIMONY RECEIVED

Alimony or separate maintenance payments made under a court decree are taxable income to the person receiving them. They are reported on Form 1040, line 11. The person making the payments deducts them on Form 1040, line 33a, as an adjustment to gross income.

Child support payments are not alimony. The person making the payments cannot deduct them. The person receiving child support payments does not have to include them in income.

TAX TIPS

An overpayment of taxes that is applied to the next year's estimated tax is considered a refund.

Income from Business (Optional Topic)

Business income or loss is reported first on Schedule C (Form 1040), *Profit or Loss From Business*, or Schedule C-EZ, *Net Profit From Business*, and then transferred to Form 1040, line 12. Taxpayers who must file a Schedule C should see a paid professional tax preparer.

Self-employed individuals who qualify to use Schedule C-EZ may be assisted by VITA and TCE volunteers who have received training on this topic, at the discretion of the site coordinator.

TAX TIPS

Voluntary payments
made that are not
required by a
divorce or separation instrument are
not alimony.

TAX TIPS

Schedule C-EZ is included in the Tax Forms Booklet
Appendix, which is a part of your
Publication 678 package.

Who Can Use Schedule C-EZ

A taxpayer can use Schedule C-EZ only if he or she:

- Had business expenses of \$2,500 or less,
- Uses the cash method of accounting,
- Did not have an inventory at any time during the year,
- Did not have a net loss from his or her business,
- Had only one business as a sole proprietor,
- Had no employees during the year,
- Is not required to file Form 4562, *Depreciation and Amortization*, for this business (See the instructions for Schedule C, line 13, to find out if the taxpayer must file.),
- Does not deduct expenses for business use of his or her home, and
- Does not have prior year unallowed passive activity losses from this business.

POTENTIAL PITFALLS



Many taxpayers erroneously report amounts from Form 1099-MISC, Miscellaneous Income, with wages or other income. This income should instead be reported on Schedule C or C-EZ and on Schedule SE, Self-Employment Tax. If the income is reported incorrectly, **IRS** may later issue a notice of proposed tax increase for the self-employment income and tax.

Completing Schedule C-EZ

Schedule C-EZ has three parts:

Part I: General Information

Part II: Figure Your Net Profit

Part III: Information on Your Vehicle

Part I: General Information

Part I is used to determine whether or not the taxpayer is eligible to use this form instead of Schedule C for reporting self-employment income. If all the criteria are met, the taxpayer then completes Part I.

Line B, Principal Business Code, is determined by looking at the code list in the *Instructions for Schedule C, Profit or Loss From Business*.

Line D, Employer ID Number, is a number which the Internal Revenue Service supplies to businesses and other professional activities. If the taxpayer does not have one, the space should be left blank.

TAX TIPS

A copy of Form
1099-MISC and
Instructions can be
found in the Tax
Forms Booklet
Appendix, which
is part of your Publication 678 Package.

Part II: Figure Your Net Profit

Gross receipts are all receipts from a trade or business including income reported on a Form 1099-MISC, *Miscellaneous Income*. All items of taxable income actually or constructively received during the year are included. Gross receipts are entered on line 1.

Total expenses include the total amount of all deductible business expenses actually paid during the year. Examples of these expenses include advertising, car and truck expenses, commissions, insurance, interest, legal and professional services and fees, office expense, rent or lease expense, repairs and mainte-

nance, supplies, taxes, travel, 50% of business meals and entertainment, and utilities (including telephone). Total expenses of \$2,500 or less are entered on line 2.

If the taxpayer uses his or her car or truck for business purposes, he or she can deduct expenses related to using the car or truck. To determine the amount of car and truck expenses that can be deducted, the taxpayer must use either the:

- Standard Mileage Rate, or
- Actual Car Expenses.

Standard Mileage Rate. If the taxpayer can and does choose to use the standard mileage rate, business miles are multiplied by the applicable mileage rate and added to the deductible parking and tolls. Car expenses using the standard mileage rate are computed as follows:

Business miles incurred during the year \times 36.5¢ per mile + Parking and tolls incurred while on business

Actual Car Expenses. If the taxpayer chooses to use the actual car expenses, only the business portion of the expenses are deductible. Deductible expenses under the actual method are computed as follows:

1. Compute the percentage of business use:

 $\frac{\text{Business miles}}{\text{Total miles}} = \% \text{ of business use}$

- 2. Determine the deductible expenses: (% of business use × total actual expenses)
 - + Parking and tolls incurred while on business

NOTE: If taxpayers depreciate their car or truck, or their total expenses are more than \$2,500, they cannot use Schedule C-EZ and should be referred to a paid professional tax preparer.

Net profit or loss is determined by subtracting line 2 from line 1 and entering the net amount on line 3.

If line 3 shows a profit, transfer this amount to Form 1040, line 12, and to Schedule SE, line 2 (except statutory employees). Attach Schedule C-EZ to Form 1040 in the correct sequence.

If line 3 is zero, show zero amount on Form 1040, line 12.

If line 3 shows a loss, the taxpayer cannot use Schedule C-EZ and should be referred to a paid professional tax preparer.

TAX TIPS ***** Generally, to use the standard mileage rate, a taxpaver must choose it in the first year the car is placed in service. In later years, the taxpayer can choose to use either the actual or standard rate. For more information on car and truck expenses, see Publication 463. Travel. Entertain-

ment, Gift, and Car

Expenses.

TAX TIPS

Schedule SE is included in the Tax Forms Booklet

Appendix, which is a part of your Publication 678 Package.

Part III: Information on Your Vehicle

Part III should be completed if the taxpayer is claiming car and truck expenses in Part II.

Self-Employment Tax

Self-employment tax is a social security tax for persons who work for themselves. It is similar to the social security tax and Medicare tax withheld from employees' wages.

Special exemptions from self-employment tax may apply to members of the clergy, members of certain religious sects, and certain nonclergy church employees.

The tax is computed on Schedule SE and transferred to the Form 1040 to be added to other taxes owed. The Schedule SE is attached to the Form 1040.

Who Must File Schedule SE

A taxpayer must file Schedule SE if he or she has:

■ Net earnings from self-employment of \$400 or more, other than church employee income (line 4 of Short Schedule SE),

OR

■ Church employee income of \$108.28 or more (line 5a of Long Schedule SE).

Exception: If the only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner AND the taxpayer has filed Form 4361 and has received IRS approval not to be taxed on these earnings, he or she does not have to file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 56.

Most taxpayers will need to complete only Section A of Schedule SE, also known as the Short Schedule SE. Follow the chart on the form to determine whether the taxpayer qualifies to file the short form. Anyone who does not qualify and who must file the long form should be referred to a paid professional tax preparer.

If the taxpayer qualifies for the short form, enter the net profit from Schedule C-EZ, line 3, on lines 2 and 3 of the Schedule SE.

POTENTIAL PITFALLS



Remember to transfer the following amounts from Form 1099-MISC to the return:

- Include any withheld income tax from Form 1099-MISC, box 4, on Form 1040A, line 39, or Form 1040, line 62.
- If the taxpayer itemizes deductions, include any withheld state or local tax from Form 1099-MISC, box 2, on Schedule A (Form 1040), Itemized Deductions, line 5.

Follow the instructions on the form to determine net earnings from self-employment on line 4 and the self-employment tax on line 5.

Enter the amount from line 5 on Form 1040, line 56.

Deduction of Self-Employment Tax

Self-employed people may claim an adjustment to income of one-half of the social security and Medicare taxes they pay.

Enter the amount from Schedule SE, line 6, on Form 1040, line 29, as an adjustment to income.

CAPITAL GAINS AND LOSSES

Both the sale of stock and the sale of a home are reported on Form 1040, line 13. The amount entered on Form 1040, line 13, is transferred from Schedule D (Form 1040), *Capital Gains and Losses*. See Lessons 12 and 13 for more information about these types of sales.

SALE OF BUSINESS PROPERTY

The sale or involuntary conversion of business property is reported on Form 1040, line 14. If taxpayers are reporting the sale of business property, they should be referred to a paid professional tax preparer.

Pension and Annuity Income

Generally, payers of pension and annuity income send Form 1099-R to the recipients. The total pension or annuity income is reported on Form 1040A, line 12a, or Form 1040, line 16a; the taxable portion is reported on line 12b (1040A) or 16b (1040). If all of the pension or annuity is taxable, make an entry on line 12b or 16b only.

For more information on pension and annuity income, see Lesson 14, *Pensions*.

Rents, Royalties, Partnerships, Estates, and Trusts

Income from rental property, royalties, partnerships, estates, and/or trusts is reported on Form 1040, line 17. Refer any taxpayer who receives income from these sources to a paid professional tax preparer.

POTENTIAL PITFALLS



Form 1099-R reports pension income, not earned income. Form 1099-R amounts are not included on line 7 of Form 1040. They are reported on Form 1040A, lines 12a and 12b or Form 1040, lines 16a and 16b. You will learn how to report pensions in Lesson 14, *Pensions*.

FARM INCOME

Farm income is reported on Form 1040, line 18. Advise taxpayers with farm income to see a paid professional tax preparer.

TAX TIPS

Form 1099-G is included in the Tax

Forms Booklet

Appendix, which is a part of your

Publication 678

Package.

UNEMPLOYMENT COMPENSATION

Unemployment compensation includes benefits to unemployed individuals that a state or the District of Columbia paid from the Federal Unemployment Trust Fund. It is reported to the recipient on Form 1099-G, *Certain Government Payments*. All unemployment compensation is taxable. Transfer the amount in box 1 of Form 1099-G to line 3 of Form 1040EZ, line 13 of Form 1040A, or line 19 of Form 1040.

Supplemental benefits provided from an employer's fund to which the employee did not contribute are sometimes thought of as unemployment benefits also. They are reported to the employee on Form W-2. Include them on line 7 of Form 1040A or 1040, or on line 1 of Form 1040EZ.

TAXWISE HINTS

When entering income for the taxpayer you have the following three choices:

Go to Line 7 and click F9 ((Link),

Click the right mouse and select "Link" or

Click on add form and select "W-2".

All the information entered into TaxWise should be exactly what is on the W-2.

Note: TaxWise automatically rounds numbers.

When an entry is made for Alimony paid, TaxWise requires the Social Security Number of the spouse receiving the alimony.

▶▶ SUMMING UP THIS LESSON ◀◀

Form 1040EZ can be used to report only income from wages, salaries, tips, qualified tuition program earnings, Alaska Permanent Fund dividends, taxable scholarships and fellowship grants, interest of \$1500 or less, and unemployment compensation.

You can report several types of income on Form 1040A:

- ➤ Wages, salaries, tips, scholarships and fellowship grants, qualified tuition program payments, and Alaska Permanent Fund dividends
- ► Interest income
- **▶** Dividend income
- ► Capital gain distributions
- ► Unemployment compensation

Use Form 1040A, Schedule 1, or Form 1040, Schedule B, to report:

- ▶ Interest and/or dividend income over \$1500 and
- ▶ Interest from Series I and/or Series EE savings bonds, issued after 1989, that is excluded from taxable income.

Report any early withdrawal penalties on Form 1040, line 32, as an adjustment to income. Do not subtract penalties from interest income.

Report capital gain distributions directly on Form 1040, line 13 or Form 1040A, line 10, if the taxpayer is not required to file Schedule D.

State and local tax refunds are included in taxable income if:

- ▶ the taxpayer itemized deductions AND
- received a tax benefit by including the state and local tax in itemized deductions.

Alimony and separate maintenance payments are taxable income to the person receiving these payments. The person paying these payments can subtract them as an adjustment to income.

►► SUMMING UP THIS LESSON ◀◀ (continued)

Business income or loss is generally beyond the scope of VITA or TCE. However, in some cases, trained volunteers may help self-employed taxpayers who qualify to use Schedule C-EZ.

Taxpayers with net self-employment income of \$400 or more must complete Schedule SE to compute self-employment tax.

Some nontaxable income is reported but is not included in taxable income:

- ➤ Tax-exempt interest
- ► Nontaxable portion of IRA distributions, including rollovers

Other income, such as prizes, awards, lottery winnings, and jury duty pay, is reported on line 21 of Form 1040, including the amount and description.

Volunteers should refer taxpayers with any of the following items to paid professional tax preparers:

- ➤ Sales of business property
- ► Income from rental property, royalties, partnerships, estates, or trusts
- ➤ Farm income

INCOME Answers to Exercises

Exercise 1

- 1. Taxable
- 2. Taxable
- 3. Nontaxable
- 4. Taxable
- 5. Taxable
- 6. Taxable
- 7. Nontaxable
- 8. Taxable
- 9. Nontaxable
- 10. Nontaxable

Exercise 2

- (A) Mandy will report \$29,250 on line 7. The tip income is included in the \$8,250.
- (B) No; Peter must file Form 1040 to pay social security and Medicare tax on his tip income.
- (C) Alex should be advised to contact the employer and request that a Form W-2 be issued or reissued. If after waiting a reasonable amount of time, it still has not been received, Erik should contact the IRS.

Exercise 3

- (A) 1. None
 - 2. \$1,000
- (B) \$398 is reported on line 2 of Form 1040EZ.
- (C) \$495 is reported on line 8a of Form 1040.

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1	

Lesson 4

ADJUSTMENTS

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about adjustments to income. There are two new adjustments to income for tax year 2002. They are the Educator Expenses and Tuition and Fees Deduction. The other adjustments covered in this lesson are traditional IRA contributions, student loan interest payments, penalty on early withdrawal of savings, alimony payments, and jury duty pay. Lesson 3 discusses an additional adjustment to income covered in the VITA training — one-half of self-employment tax.

The remaining adjustments — Archer MSA deduction; moving expenses; self-employed health insurance deduction; and self-employed SEP, SIMPLE, and qualified plans — are not covered in VITA training. Taxpayers who need assistance with these adjustments should be referred to a paid professional tax preparer.

After completing this lesson you should be able to:

- Calculate and accurately report adjustments to income.
- Identify which IRA contributions are within the scope of the VITA/TCE program.
- Identify contribution limits for IRAs.
- Calculate and report non-deductible IRA contributions and carry-over on Form 8606.

TAX TIPS

Some taxpayers can make tax deductible contributions to an Archer Medical Savings Account (Archer MSA), even if they do not itemize deductions.

Refer taxpayers with a medical savings account to a paid professional tax preparer. They can also get Publication 969, Medical Savings Accounts (MSAs), for more information.

Adjustments to Income

Adjustments are subtractions from total income. Total income minus adjustments results in **adjusted gross income** (**AGI**), an important number for tax purposes. Adjusted gross income is used to figure some limitations. In addition, it is used to figure income tax in some states.

Taxpayers cannot take any adjustments to income on Form 1040EZ. On Form 1040EZ total income and adjusted gross income are the same. Form 1040A filers can take adjustments for educator expenses, contributing to a traditional IRA, the student loan interest deduction, and tuition and fees payments. Form 1040 filers can take any of the adjustments (for which they are eligible).

DEDUCTION FOR EDUCATOR EXPENSES

If the taxpayer is an eligible educator, he or she can deduct as an adjustment to income up to \$250 in qualified expenses. The taxpayer can deduct these expenses even if he or she does not itemize deductions on Schedule A (Form 1040). This adjustment to income is for expenses paid or incurred in 2002. Previously, these expenses were deductible only as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit.

Eligible educator

The taxpayer is an eligible educator if, for the tax year, he or she is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide, and he or she works at least 900 hours during a school year in a school that provides elementary or secondary education as determined under state law.

Qualified expenses

Qualified expenses are the *unreimbursed expenses* paid or incurred for books, supplies, computer equipment (including related software and services), other equipment and supplementary materials that the taxpayer uses in his or her classroom. For courses in health and physical education, expenses for supplies are qualified expenses only if they are related to athletics.

To be deductible as an adjustment to income, the qualified expenses must be more than the following amounts for the tax year:

- The interest on qualified U.S. savings bonds that the taxpayer excluded from income because he or she paid qualified higher education expenses.
- Any distributions from a qualified tuition program that the taxpayer excluded from income, or
- Any tax-free withdrawals by the taxpayer from a Coverdell education savings account.

The educator expense can be claimed on Form 1040, line 23 or Form 1040A, line 16.



Individual Retirement Arrangements

An **Individual Retirement Arrangement (IRA)** is a taxsheltered savings plan set up by the taxpayer, generally for retirement income. This lesson discusses only **traditional IRAs** (IRAs other than Roth IRAs, SIMPLE IRAs, or Coverdell education savings accounts (ESAs). Contributions to the nontraditional IRAs are not deductible as adjustments to income.

For more information on nontraditional IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

Contributions to a traditional IRA can be either deductible or nondeductible. Earnings and gains on the contributions are not taxed until withdrawn from the traditional IRA account.

Example 1

Anna contributed \$2,500 to her traditional IRA account at her local bank. During 2002 she earned \$140 of interest on her traditional IRA. All of the interest was added to her traditional IRA savings account.

Anna will not have to pay tax on the interest until she withdraws it from her traditional IRA account.

Contributions

Anyone under 70 1/2 years of age (at the end of the tax year) who has taxable compensation can contribute to a traditional IRA. **Compensation** includes wages, salaries, commissions, tips, bonuses, professional fees, and earnings from self-employment. Alimony or separate maintenance payments that are included in total income are also compensation for traditional IRA purposes. Compensation *does not include* interest, rents, dividends, pension and annuity income, deferred compensation received, certain partnership income, or income you can exclude.

General Limit

The most that can be contributed for any year to a traditional IRA is the lesser of:

- \$3,000 (\$3,500 if age 50 or older), or
- Compensation that is includible in income for the year.

If a taxpayer has more than one traditional IRA, the taxpayer must combine all of the traditional IRAs and treat them as one when figuring the amount that can be contributed for the year.

SPECIAL POPULATIONS



Persons who are 70 1/2 years of age or older before the end of the tax year cannot contribute to an IRA and must take required distributions from their IRAs.

SPECIAL POPULATIONS



Individuals serving in the U.S. Armed Forces or in support of the U.S. Armed Forces in designated "combat zones" have additional time to make a qualified retirement contribution to a traditional IRA. For more information on this extension, see Publication 3, Armed Forces' Tax Guide

Tax Tips

Contributions to a traditional IRA reduce the limit for contributions to Roth IRAs.

Spousal IRA limit

If taxpayers file a joint return and one spouse's compensation is less than that of the other spouse's compensation, the spouse with the higher compensation may establish a traditional IRA for the other spouse. The most that can be contributed for that other spouse is the lesser of:

- 1) \$3,000 (\$3,500 if age 50 or older), or
- 2) The total compensation includible in the gross income of both spouses for the year, reduced by:
 - a) IRA contributions for the spouse with the greater compensation,
 - b) Nondeductible IRA contributions of the spouse with the greater compensation, and
 - c) Any contribution for the year to a Roth IRA for the spouse with the greater compensation.

The total combined contributions to both traditional IRAs cannot exceed the lesser of:

- \blacksquare \$6,000 (\$7,000 if both individuals are age 50 or older), or
- The total taxable compensation of both spouses.

Excess Contributions

Generally, an excess contribution is the amount contributed to a traditional IRA that is more than the lesser of the:

- 1) Taxable compensation for the year, or
- 2) \$3,000 (\$3,500 if age 50 or older).

This limit applies whether the contributions are deductible or nondeductible. Contributions made in the year the taxpayer reaches age 70 1/2 and any later year are also excess contributions.

In general, if the excess contribution for a year and any earnings on it are not withdrawn by the due date of the tax return (including extensions), the taxpayer is subject to an additional 6% tax. The additional 6% tax must be paid each year on the excess amounts that remain in the traditional IRA at the end of the tax year. The tax cannot be more than 6% of the value of the IRA as of the end of the tax year. The excise tax is figured on Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.*

A taxpayer who has taxable compensation, but can no longer contribute to a traditional IRA because of age (70 1/2 years or older) may continue to contribute to a spouse's traditional IRA until the year in which the spouse reaches 70 1/2.

Example 2

Eldridge is a single 73-year-old attorney. He earned \$12,000 during the year.

Eldridge had compensation for traditional IRA purposes but he cannot make an IRA contribution because he is 70 1/2 or older.

Example 3

Jane and Mike are married. Jane works in the home raising their two children. Mike works outside the home as an electrician and earned \$75,000 during the year.

If Jane and Mike file a joint return, a traditional IRA contribution can be made for Jane.

Exer	xercise 1				
A.	Liz receives alimony which is included in her total income. All of her other income is from interest and dividends. Can Liz make a traditional IRA contribution? Explain.				
В.	David is 73 and works part time in a hardware store. David's wife, Mary, does not work outside of the home. Mary is 68. Can David make a traditional IRA contribution for Mary? Explain.				
C.	Carla receives all her income from a rental property, interest income, and dividends. Can Carla make a traditional IRA contribution? Explain.				
D.	Joy is 62 years old. Most of her income comes from a pension. However, Joy did earn \$1,250 doing consumer testing. How much can Joy contribute to a traditional IRA? Explain.				

Deductible IRA Contributions

Generally, you can deduct the lesser of the contributions to your traditional IRA for the year or the general limit (or the spousal IRA limit, if it applies). A deduction for a traditional IRA depends on:

- Whether or not the taxpayer or taxpayer's spouse is covered by a retirement plan set up by an employer for any part of the year,
- The taxpayer's **modified adjusted gross income**, and
- The taxpayer's filing status.

Common Queries

If the Pension Plan box on Form W-2 has a check in it, the taxpayer is covered by an employer retirement plan. Generally, **modified adjusted gross income** is the adjusted gross income without consideration of deductions for a traditional IRA or student loan interest, or any exclusion of Series EE or Series I bond interest shown on Form 8815, *Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989*.

Not covered by an employer retirement plan.

A taxpayer whose filing status is single, head of household, or qualifying widow(er), and who is not covered by an employer retirement plan, can take a full traditional IRA deduction of either his or her taxable compensation or \$3,000 (whichever amount is smaller). The \$3,000 amount is increased to \$3,500 if the taxpayer is age 50 or older.

Example 4

Cyril is single and 40 years of age. His modified adjusted gross income is \$50,000. He is not covered by a retirement plan at work. Cyril's traditional IRA contribution of \$3,000 is deductible.

Married taxpayers who file separate returns for a taxable year and who live apart at all times during the taxable year are treated as single and can take a full IRA deduction, if not covered by an employer plan.

Married taxpayers who file jointly or separately may each be able to take the full IRA deduction of \$3,000 (\$3,500 if age 50 or older) or taxable compensation (whichever amount is smaller), if they had taxable compensation and were not covered by an employer retirement plan. The total deduction for a joint return cannot exceed \$6,000 (\$7,000 if both individuals are age 50 or older). When determining the allowable deduction each spouse figures the deduction separately.

Covered by an employer retirement plan.

If the taxpayer is covered by a retirement plan at work, the traditional IRA deduction will be reduced or eliminated, as shown in **Table 1**, depending on filing status and modified AGI.

SPECIAL POPULATIONS



Reservists and volunteer firefighters should consult Publication 590 to determine if they are covered by an employer plan or not.

Table 1.
Traditional IRA Deduction Phaseout Chart
(If taxpayer is covered by an employer retirement plan)

Allowable traditional

	IRA deduction		
	reduced modified		zero when modified AGI is:
Filing Status	at least	but less than	
Single or Head of household	\$34,000	\$44,000	\$44,000 or more
Married filing jointly or Qualifying widow(er)	\$54,000	\$64,000	\$64,000 or more
Married filing separately	\$0.01	\$10,000	\$10,000 or more

Example 5

Emily, 36 years old, is single. Her modified AGI was \$50,000. She is covered by a retirement plan at work. Emily's \$3,000 traditional IRA contribution is not deductible on her tax return because her modified adjusted gross income is at least \$44,000.

If either the taxpayer or the taxpayer's spouse is covered by an employer retirement plan, he or she may be entitled to only a partial deduction or no deduction at all, depending on filing status and modified adjusted gross income, as shown in **Table 2**, below.

Example 6

David and Ruth are filing a joint return. David earned \$65,000 and is covered by his employer's retirement plan. Ruth, age 32, is a homemaker, and has no compensation. David, age 36, contributed \$2,800 to his traditional IRA and \$3,000 to a traditional IRA for Ruth.

Because David is covered by his employer's retirement plan, the modified AGI limits apply (Table 1). Based on Table 1, David is not allowed a deduction for his traditional IRA contributions. Because David made traditional IRA contributions for Ruth, they can take a deduction on the tax return for her IRA contributions. Ruth is not covered by an employer's retirement plan. Their compensation for IRA purposes is \$65,000 and their modified AGI is not more than \$150,000 (see Table 2).

Table 2. Traditional IRA Deduction Phaseout Chart (If taxpayer is not covered, but the spouse is)						
		vable tradit leduction i				
	reduced i		zero when modified AGI is:			
Filing Status	more than	but less than	Adl is.			
Married filing jointly or Qualifying widow(er)	\$150,000	\$160,000	\$160,000 or more			
Married filing separately	\$0.01	\$10,000	\$10,000 or more			

Example 7

Assume still that David earned \$65,000 and is covered by his employer's retirement plan. Assume too that Ruth is employed; she earned \$66,000 and she is not covered by her employer's retirement plan. David cannot deduct his traditional IRA contribution, but Ruth can deduct hers. The modified AGI limits that apply to David are shown in Table 1. Table 2 modified AGI limits apply to Ruth's deduction. Her deduction would not be reduced unless the couple's modified AGI was more than \$150,000. It would not be eliminated unless their modified AGI was \$160,000 or more.

Exercise 2

- **A.** Angela and Joe are married and file a joint return. Joe, age 23, is covered by a retirement plan at work, but Angela, age 25, is not. Joe earned \$25,000 and Angela earned \$20,000; their modified AGI is \$45,000. Is any portion of Angela's traditional IRA contribution deductible, and why?
- **B.** Annette, age 26, is single. She earned \$23,000, and her modified AGI is \$24,500. She made a \$500 contribution to a traditional IRA. Annette is covered by a retirement plan at work. Is any portion of her contribution deductible, and why?
- C. Richard and Lynn are married and lived together during the year. They file separate returns. Richard is covered by a retirement plan at work. Lynn is not covered by a retirement plan at work. Richard, age 40, earned \$17,000 and contributed \$1,400 to a traditional IRA. Lynn, age 33, worked part-time and earned \$4,500. She contributed \$1,000 to a traditional IRA. Can Richard or Lynn deduct any of the IRA contributions, and why?

When to Deduct Traditional IRA Contributions

Individuals may deduct traditional IRA contributions on their 2002 tax return if the contributions are made in 2002 or by April 15, 2003. Taxpayers may not deduct on their 2002 tax return contributions made in 2002 which were deducted on the 2001 tax return. The contributions do not have to be made before the return is filed. If the taxpayer deducts traditional IRA contributions on the 2002 tax return but does not make the traditional IRA contributions by April 15, 2003, for the exact amount deducted, the taxpayer must file an amended tax return.

SPECIAL POPULATIONS



Taxpayers who receive Social Security Benefits should complete the worksheets in Appendix B of Publication 590 to determine the modified adjusted gross income and the allowable IRA deduction.

Using the Worksheet and Reporting the Deduction

Use the IRA Deduction Worksheet in the Form 1040A or Form 1040 instructions booklet to figure the traditional IRA deduction.

The traditional IRA deduction is reported on Form 1040A, line 17 or Form 1040, line 24. On joint returns when both spouses are making deductible traditional IRA contributions, enter the total contribution on line 17 or 24.

Example 8

Nick and Susan file a joint return. Both work, and Nick, age 27, was covered by a retirement plan, but Susan, age 25, was not. Nick earned \$12,300 and Susan earned \$10,990. Their total income, including interest, is \$23,400. Nick and Susan each contributed \$500 to a traditional IRA.

The completed worksheet and Form 1040, lines 22 through 35, for Nick and Susan are shown in Exhibits 1 and 2, respectively. The information for Nick is shown in the column for *Your IRA*. The information for Susan is shown in the column for *Spouse's IRA*.

		/			
Bef	ore you begin:	√ Complete Form 1040, lines 27 through 33a, i √ Figure any amount to be entered on the dotter		•	33)
		✓ Be sure you have read the list on page 29.	u mie next	to fine 34 (see page	
		v Be sure you have read the list on page 29.			
				Your IRA	Spouse's IRA
	•	a retirement plan (see on page 31)?		1a. XYes □No	
1b.	Next. If you checked		on		1b. ☐ Yes ☒ No
2.	-	wn below that applies to you.			
	from your spouse	sehold, or married filing separately and you lived ap or all of 2002, enter \$44,000	art		
	Qualifying widow(64.000	160,000
		tly, enter \$64,000 in both columns. But if you checked to 1b, enter \$160,000 for the person who was		2a. <u>64,000</u>	2b. 160,000
	 Married filing sep 2002, enter \$10,00 	arately and you lived with your spouse at any time	,		
3.	Enter the amount from	n Form 1040, line 22	3,400		
4.		1040, line 23, lines 27 through 33a, and	0		
		ed on the dotted line next to line 34 . 4.	0	5 ₂ 23,400	_{5h} 23,400
5.		ine 3. Enter the result in both columns		5a. <u> </u>	5b. <u>23,400</u>
6.	□ No. STOP None	5 less than the amount on line 2? of your IRA contributions are deductible. For deductible IRA contributions, see Form 8606.	etails on		
		e 5 from line 2 in each column. If the result is \$10	0.000 or		
	more, enter	\$3,000 (\$3,500 if age 50 or older at the end of 2	2002) on	40.600	176 600
		at column and go to line 8		6a. <u>40,600</u>	6b. 136,600
7.	If the result is not a	% (.30) (by 35% (.35) if age 50 or older at the end of multiple of \$10, increase it to the next multiple of 0.30 to \$500). If the result is \$200 or more, enter the	\$10 (for	7a3,000	7b. 3,000
	But if it is less than \$	200, enter \$200			
8.		your spouse's if filing jointly, and other			
		orm 1040, minus any deductions on Form Do not reduce wages by any loss from			
		25	3,290		
)O :C		
	spouse is 5	filing jointly and line 8 is less than \$6,000 (\$6,50 0 or older at the end of 2002; \$7,000 if both spouse the end of 2002), stop here and see Pub. 590 to figure too.	es are 50		
9.	Enter traditional IRA	contributions made, or that will be made by April 1	5, 2003,	500	=00
		on line 9a and to your spouse's IRA on line 9b		9a500	9b. 500
10.		smallest of line 7a, 8, or 9a. On line 10b, enter the			
		tis is the most you can deduct. Add the amounts on I			
		total on Form 1040, line 24. Or, if you want, you mattreat the rest as a nondeductible contribution (see For		6 500	10b. 500

Exhibit 2

Nick and Susan's Form 1040, Lines 22-35

	22	Add the amounts in the far right column for lines 7 through 21	. This	is your total income	▶ 22	23,400
.	23	Educator expenses (see page xx)	23			
Adjusted	24	IRA deduction (see page 27)	24	1,000		
Gross	25	Student loan interest deduction (see page 28)	25			
Income	26	Tuition and fees deduction (see page XX)	26			
	27	Archer MSA deduction. Attach Form 8853	27			
	28	Moving expenses. Attach Form 3903	28			
	29	One-half of self-employment tax. Attach Schedule SE .	29			
	30	Self-employed health insurance deduction (see page 30)	30			
	31	Self-employed SEP, SIMPLE, and qualified plans	31			
	32	Penalty on early withdrawal of savings	32			
	33a	Alimony paid b Recipient's SSN ▶	33a		(/////	
	34	Add lines 23 through 33a			. 34	1,000
	35	Subtract line 34 from line 22. This is your adjusted gross	incom	e	▶ 35	22,400

Common Queries

A taxpayer does not have to make deductible IRA contributions. The entire IRA contribution may be treated as nondeductible.

Nondeductible IRA Contributions

Although the deductible amount of traditional IRA contributions can be reduced or eliminated because of the modified adjusted gross income limitation, a taxpayer can make non-deductible contributions to new or existing traditional IRAs. Earnings and gains on these contributions are not taxed until they are distributed to the taxpayer.

The total traditional IRA contribution, whether deductible or nondeductible, cannot be more than the taxpayer's taxable compensation or \$3,000 (\$3,500 if age 50 or older), whichever amount is smaller.

Taxpayers must complete Form 8606, *Nondeductible IRAs*, for each year that nondeductible contributions are made.

If taxpayers do not report nondeductible contributions, all of the contributions to a traditional IRA will be treated as deductible. This means all distributions will be taxed unless the taxpayer can show, with satisfactory evidence, that nondeductible contributions were made.

Example 9

Rachel, age 35, is single and wants to contribute the maximum amount possible to her traditional IRA. She is covered by her employer's retirement plan and her total income, Form 1040A Line 15, is \$39,000. Her total basis in traditional IRAs from line 14 of her 2002 Form 8606 is \$9,000. The completed IRA Deduction Worksheet and Form 8606 are shown in Exhibits 3 and 4.

Bef	fore you begin: $\sqrt{}$ Be sure you have read the list that begins on page 30.				
			Your IRA	Spouse	's IRA
1a.	Were you covered by a retirement plan (see this page)?	1a.	X Yes No		
	If married filing jointly, was your spouse covered by a retirement plan?			1b. Yes	□ No
	Next. If you checked "No" on line 1a, and, if married filing jointly, "No" on line 1b, skip lines 2–4, enter \$3,000 on line 5a (and 5b if applicable), and go to line 6. Otherwise, go to line 2.				
2.	Enter the amount shown below that applies to you.				
	• Single, head of household, or married filing separately and you lived apart from your spouse for all of 2002, enter \$44,000				
	• Qualifying widow(er), enter \$64,000		44,000		
	• Married filing jointly, enter \$64,000 in both columns. But if you checked "No" on either line 1a or 1b, enter \$160,000 for the person who was not covered by a plan	2a.	44,000	2b	
	• Married filing separately and you lived with your spouse at any time in 2002, enter \$10,000				
3.	Enter the amount from Form 1040A, line 15				
4.	Enter the amount, if any, from line 16 40				
5.	Subtract line 4 from line 3. Enter the result in both columns	5a.	39,000	5b	
6.	Is the amount on line 5 less than the amount on line 2?				
	No. None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.				
	X Yes. Subtract line 5 from line 2 in each column. If the result is \$10,000 or more,				
	enter \$3,000 (\$3,500 if age 50 or older at the end of 2002) on line 7 for that	_	5,000	CI.	
7.	column	6a.	5,000	6b	
/•	result is not a multiple of \$10, increase it to the next multiple of \$10 (for example, increase				
	\$490.30 to \$500). If the result is \$200 or more, enter the result. But if it is less than \$200,	_	1,500		
	enter \$200	7a.	1,000	7b	
8.	Enter the amount from Form 1040A, line 7 8				
	If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is 50 or older at the end of 2002; \$7,000 if both spouses are 50 or older at the end of 2002), stop here and see Pub. 590 to figure your IRA deduction.				
9.	Enter traditional IRA contributions made, or that will be made by April 15, 2003, for 2002 to your IRA on line 9a and to your spouse's IRA on line 9b	9a.	3,000	9b	
10.	On line 10a, enter the smallest of line 7a, 8, or 9a. On line 10b, enter the smallest of line 7b, 8, or 9b. This is the most you can deduct. Add the amounts on lines 10a and 10b and enter the total on Form 1040A, line 17. Or, if you want, you may deduct a smaller amount and treat the rest as a nondeductible contribution (see Form 8606)	100	1,500	10b.	
	and treat the rest as a nondeductible contribution (see Form 8000)	10a.		100	

Exhibit 4 Rachel's Form 8606

Nondeductible Contributions to Traditional IRAs and Distributions From Traditional, SEP, and SIMPLE IRAs

	 Complete Part I only if: You made nondeductible contributions to a traditional IRA for 2002, You took distributions from a traditional, SEP, or SIMPLE IRA in 2002 (other the recharacterization, or return of certain contributions) and you made nondeductible contributions or an earlier year, or You converted part, but not all, of your traditional, SEP, and SIMPLE IRAs to Roth IRAs in you recharacterized) and you made nondeductible contributions to a traditional IRA in 2 	ibutioi 2002 (ns to a traditional	al IR/ ortio
1	Enter your nondeductible contributions to traditional IRAs for 2002, including those made for 2002 from January 1, 2003, through April 15, 2003 (see page 5 of the instructions)	1	1500	00
2	Enter your total basis in traditional IRAs for 2001 and earlier years (see page 5 of the instructions)	2	9000	00
3	Add lines 1 and 2 In 2002, did you take a distribution from traditional, SEP, or SIMPLE IRAs or make a Roth IRA conversion? No Enter the amount from line 3 on line 14. Do not complete the rest of Part I. Yes Go to line 4.	3	10,500	00
13	Add lines 11 and 12. This is the nontaxable portion of all your distributions	13		
14	Subtract line 13 from line 3. This is your total basis in traditional IRAs for 2002 and earlier years.	14	10,500	00
15	Taxable amount. Subtract line 12 from line 7. Also include this amount on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b.	15		

Cat. No. 63966F

Form **8606** (2002)

Form 1040A, line 11b; or Form 1040NR, line 16b.

age 591/2 at the time of the distribution (see page 6 of the instructions).

For Paperwork Reduction Act Notice, see page 8 of the instructions.

Note: You may be subject to an additional 10% tax on the amount on line 15 if you were under

Part I



- **A.** Richard, who is single and 26 years old, wants to make the maximum traditional IRA contribution. He earned \$1,854 for giving private tennis lessons, \$2,000 interest income, and \$8,000 rental income. How much can Richard contribute to a traditional IRA?
- **B.** Mary is 55 and retired two years ago. She received an \$8,000 taxable pension and \$750 for baby sitting during the past year. How much can Mary contribute to a traditional IRA?
- C. Bill and Kathy are both employed and each earned \$15,000 in 2002. Both Bill and Kathy are age 32. Neither spouse was covered by an employer retirement plan for any part of the year. In July 2002, Bill contributed \$1,200 to his 2002 traditional IRA. In February 2003, he contributed \$800 to his 2002 traditional IRA. Kathy contributed \$400 to her 2002 traditional IRA. They file a joint return.
 - 1. What is Bill's deductible traditional IRA contribution?
 - **2.** What is Kathy's deductible traditional IRA contribution?

Additional Taxes and Penalties

Taxpayers are generally subject to additional taxes and penalties for:

- Contributing more to a traditional IRA than is allowed,
- Making traditional IRA withdrawals before age 59 1/2, and
- Not withdrawing enough traditional IRA funds after age 70 1/2.
- Investing in collectibles

There are penalties for overstating the amount of nondeductible contributions and for failure to file Form 8606, if required.

Saver's Credit

Refer to Lesson 6 to determine if a taxpayer is also eligible to receive the Saver's Credit based on their contributions to an IRA.

STUDENT LOAN INTEREST DEDUCTION

Taxpayers may be able to deduct interest due and paid in 2002 on a qualified student loan (even if they took out the loan before 2002). The deduction is reported on Form 1040A, line 18, or on Form 1040, line 25.

The student loan interest deduction for 2002 cannot be more than \$2,500 and is subject to the limit described later.

A taxpayer cannot claim the student loan interest deduction if another person can claim him or her as a dependent or if the taxpayer does not file a joint return with his or her spouse.

NOTE: Effective for 2002, student loan interest qualifies as an adjustment even if the required or voluntary payments began more than 60 months ago.

Deduction Limit

The taxpayer's deduction may be limited, depending on the taxpayer's modified AGI. The following table explains when the limit applies.

Limit on Student Loan Interest Deduction					
If your filing status is	AND your modified AGI is	THEN			
Single, head of household, or qualifying widow(er)	\$50,000 or less	You can deduct all your interest, up to \$2,500.			
	More than \$50,000, but less than \$65,000	Your deduction is limited.			
	\$65,000 or more	You cannot claim this deduction.			
Married filing jointly	\$100,000 or less	You can deduct all your interest up to \$2,500.			
	More than \$100,000, but less than \$130,000	Your deduction is limited.			
	\$130,000 or more	You cannot claim this deduction.			

Modified AGI

Modified AGI means AGI figured before taking the deduction for student loan interest payments and after adding back any of the following:

- Foreign earned income exclusion,
- Foreign housing exclusion or deduction,

Tax Tips ******

A taxpayer can deduct payments made in a later year when he or she is no longer claimed as a dependent.

TAX TIPS********

Interest is deductible

on a qualified
education loan if:
a) The loan is for
the sole purpose of
paying qualified
higher education
expenses; and

b) The individual claiming the interest is legally obligated to repay the loan.

Revolving lines of credit generally would not constitute qualified education loans unless the borrower agreed to use the line of credit to pay *only* qualifying education expenses.

- Exclusion of income for bona fide residents of Guam, Puerto Rico, American Samoa, or the Northern Mariana Islands.
- Qualified tuition and related expenses.

Figuring the limit

Taxpayers whose modified adjusted gross income is more than \$50,000 but less than \$65,000 (more than \$100,000 but less than \$130,000 for taxpayer's filing a joint return) figure their student loan interest deduction by completing the following two steps.

Step 1. Multiply the smaller of the actual interest paid on a qualified student loan, or \$2,500, by a fraction:

Step 2. Subtract the result from step 1 from the smaller of the actual interest paid on a qualified student loan, or \$2,500.

Example 10

During 2002, Rick paid interest of \$1,500 on a qualified student loan. His modified AGI is \$115,000 and he is filing a joint return with Paula his wife. Rick's student loan deduction for 2002 is \$750, as figured below.

Step 1.
$$\frac{\$115,000 - \$100,000}{\$30,000} = .50$$
$$\$1,500 \times .50 = \$750$$
Step 2.
$$\$1,500 - \$750 = \$750$$
(Rick's student loan interest deduction)

Example 11

The facts are the same in Example 10, except that the actual interest paid on the qualified student loan is \$2,700. Because the interest Rick paid is greater than the maximum allowable student loan interest deduction (\$2,500), he will multiply his fraction by \$2,500.

Step 1.
$$\frac{\$115,000 - \$100,000}{\$30,000} = .50$$
$$\$2,500 \times .50 = \$1,250$$
Step 2.
$$\$2,500 - \$1,250 = \$1,250$$
(Rick's student loan interest deduction)

(In this case, Rick's deduction is based on the maximum amount allowable and not on the actual amount of interest he paid.)

Qualified Student Loan

A qualified student loan is a loan the taxpayer took out to pay qualified higher education expenses:

- For the taxpayer, the taxpayer's spouse, or the taxpayer's dependent (at the time that the taxpayer took out the loan),
- Paid or incurred within a reasonable time before or after the taxpayer took out the loan, and
- For education furnished during a period when the recipient was an eligible student.

Qualified Higher Education Expenses

These expenses are the costs of attending an eligible educational institution, including graduate school. Generally, these costs include tuition, fees, room and board, books, supplies, equipment, and other necessary expenses, such as transportation. You must reduce these costs by the following:

- Nontaxable employer-provided educational assistance benefits,
- Nontaxable distributions from a Coverdell ESA,
- U.S. savings bond interest that is nontaxable because you paid qualified higher educational expenses,
- Qualified scholarships that are nontaxable,
- Veterans' educational assistance benefits, and
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses.

Eligible Educational Institution

Generally, an eligible educational institution means either:

- A college, university, vocational school, or other postsecondary educational institution eligible to participate in Department of Education student aid programs. This category includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions, or
- An institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

Eligible Student

An eligible student is one who:

- Is enrolled in a degree, certificate, or other program (including a program of study abroad that is approved for credit by the institution at which the student is enrolled) leading to a recognized educational credential at an eligible educational institution, and
- Is carrying at least one-half the normal full-time work load for the course of study the student is pursuing.

Loan From Related Person

A taxpayer cannot deduct interest on a loan the taxpayer gets from a related person. Related persons include the taxpayer's spouse, brother(s) and sister(s), half-brother(s) and half-sister(s), ancestors (parents, grandparents, etc.) and lineal descendants (children, grandchildren, etc.).

Refinanced Loan

If the taxpayer refinances a qualified student loan, the new loan can also be a qualified student loan.

Tuition and Fees Deduction

Prior to 2002 taxpayers could claim a deduction for education expenses on Form 1040, Schedule A as a miscellaneous expense limited to 2% of AGI.

Begining in 2002, taxpayers can deduct an amount equal to the qualified tuition and related expenses paid during the tax year as an adjustment to income. The adjustment is reported on Form 1040, line 26, or Form 1040A, line 19.

To claim the deduction the taxpayer must have incurred *qualified expenses* for an *eligible student* to attend an *eligible educational institution* during the tax year.

Qualified Expenses

Qualified tuition and related expenses include tuition and fees required for enrollment or attendance at an eligible educational institution and generally include fees for:

- Course-related books, supplies and equipment, and
- Student activities.

The fees must be paid to the institution as a condition of enrollment or attendance.

Qualified tuition and related expenses do not include the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation or similar personal, living or family expenses, even if the fees must be paid to the institution as a condition of enrollment or attendance.

Eligible Student

The deduction can be claimed for the taxpayer, the taxpayer's spouse (if filing a joint return) and any dependent (for whom the taxpayer claims a dependency exemption).

TAX TIPS

No deduction is allowed unless the taxpayer includes the name and taxpayer identification number of the eligible student on the tax return.

TAX TIPS

* * * * * * * * * *
No deduction is
allowed to a taxpayer if they are the
dependent of
another person.

Married taxpayers that file as married filing a separately return cannot take the deduction.

An individual who is the dependent of another taxpayer cannot claim the deduction.

Eligible Educational Institution

An eligible educational institution is generally any accredited public, nonprofit, or private postsecondary institution eligible to participate in the student aid programs administered by the Department of Education. Most universities and colleges, including community colleges, meet these requirements.

Deduction Amount

The deduction amount is determined by the taxpayer's filing status and adjusted gross income.

The total amount of qualified tuition and related expenses are reduced by:

- Distributions from qualified state tuition programs
- Distributions from Coverdell ESAs
- Interest from savings bonds used for higher education expenses

IF your filing status is	AND your modified AGI is	THEN
Single, Head of Household, or Qualifying widow (er)	Equal to or less than \$65,000	You can deduct all of your qualified tuition and fees up to \$3,000.
(CI)	More than \$65,000	You cannot claim the credit.
Married filing jointly	Equal to or less than \$130,000	You can deduct all of your qualified tuition and fees up to \$3,000.
	More than \$130,000.	You cannot claim the credit.
Married filing separately	Any amount	You cannot claim the credit

Modified adjusted gross income for purposes of the deduction for qualified tuition and related fees is adjusted gross income before the deduction for qualified tuition and related fees and after adding back the following:

- Foreign earned income exclusion,
- Foreign housing exclusion or deduction,
- Exclusion of income for bona fide residents of Guam, Puerto Rico, American Samoa, or the Northern Mariana Islands.

Figuring the deduction

The taxpayer should use the worksheet in the instruction booklet for Form 1040 or Form 1040A to figure the allowable deduction for tuition and fees. In certain circumstances, the taxpayer may be required to use the worksheet in Publication 970 to figure the deduction.

Example 12

Luis and Priscilla file a joint return for 2002. Their 1040 line 22 total income is \$49,620. In 2002, Priscilla paid \$1,300 for classes taken at the local university. She had allowable IRA deductions of \$1,500. Their allowable tuition and fees deduction is \$1,300, shown in Exhibit 5.

Exhibit 5

Luis and Priscilla's Tution and Fees deduction worksheet

Before you begin:	 ✓ Complete Form 1040, lines 27 through 33a, if they apply to you. ✓ Figure any amount to be entered on the dotted line next to line 34 (see page 5) ✓ See the instructions for line 26 above. ✓ Be sure you have read the Exception above to see if you can use this wor instead of Pub. 970 to figure your deduction. 	U	,
2. Enter the total of the ar amount you entered on	Form 1040, line 22	1. 2. 3.	1,500 48,120
4. Tuition and fees deduction	ine 3 is more than \$65,000 (\$130,000 if married filing jointly), stop here. You on for tuition and fees. tion. Enter the total qualified tuition and fees (defined above) you paid in 2002. \$3,000. Also, enter this amount on Form 1040, line 26	4.	1,300

No Double Benefits

A taxpayer cannot:

- Deduct higher education expenses on Schedule A and claim a deduction for the same expenses.
- Claim the Hope Credit or the lifetime learning credit for an individual in the same year as a deduction for quailified tuition and related expenses are claimed.
- Claim a credit based on expenses paid with a tax-free scholarship, grant, or an employer-provided educational assistance.

ONE-HALF OF SELF-EMPLOYMENT TAX

Report on Form 1040, line 29, the adjustment for one-half of self-employment tax from Schedule SE. This subject was covered in Lesson 3, for volunteers who will be helping self-employed taxpayers.

Penalty on Early Withdrawal of Savings

Depositors may withdraw funds from ordinary savings accounts any time they wish. However, if they withdraw funds from a time deposit (such as a certificate of deposit) before the maturity date, a penalty is charged. Form 1099-INT reports the interest earned as well as any early withdrawal penalties.

As you learned in Lesson 3, taxpayers must report the total amount of interest earned. They cannot subtract the early withdrawal penalty from the interest earned and report the difference. The early withdrawal penalty can be claimed as an adjustment only on Form 1040, line 32. The entire penalty is deducted, even if it is greater than the interest income.

Example 13

Arlene has one Form W-2 and one Form 1099-INT and no other income. Her Form 1099-INT shows both interest income and an early withdrawal penalty. Arlene does not pay alimony, and she did not make a contribution to a traditional IRA. She will not itemize deductions, and she cannot claim any tax credits.

Arlene should file Form 1040 to claim the adjustment for the penalty on early withdrawal of savings.

ALIMONY PAID

As you learned in Lesson 3, alimony and separate maintenance payments are taxable to the person receiving these payments. The person paying the alimony or separate maintenance can claim it as an adjustment to income. This adjustment can be claimed only on Form 1040. The amount paid during the year and the recipient's social security number are entered on line 33a and 33b, respectively. Claim the adjustment only for amounts paid during the tax year.

Child support is not the same as alimony or separate maintenance payments. Child support is not taxable to the recipient and cannot be claimed as an adjustment by the payer.

JURY DUTY PAY GIVEN TO EMPLOYER

As you learned in Lesson 3, *Income*, jury duty pay received by taxpayers is included in other income on line 21 of Form 1040.

Some employees receive their regular wages from their employers when they are serving on a jury instead of working at their jobs. Often the jury duty pay the employees receive is turned over to their employers. The amount given to the employer may be claimed as an adjustment to income. On the dotted line next to line 34, write "jury pay" and the amount. Include jury duty pay with the adjustments claimed on lines 23 through 33a.

SPECIAL POPULATIONS



Divorced or separated individuals have tax questions that are unique to their situation. Some taxpayers may ask vou complex auestions like "How much of my payment represents alimony and how much is child support?" or "How do I report alimony received this year to make up for payments missed in previous years?" **VITA/TCE** materials prepare you to answer simple alimony questions; advise taxpayers with complex situations to seek paid professional tax assistance.

OTHER ADJUSTMENTS

The other adjustments that can be claimed on Form 1040 are beyond the scope of the VITA/TCE Program. Taxpayers who have adjustments that aren't discussed in this lesson should be advised to seek paid professional tax assistance.

TOTAL ADJUSTMENTS AND ADJUSTED GROSS INCOME

Add all adjustments and enter the total on Form 1040A, line 20, or Form 1040, line 34. Subtract the total adjustments from the total income on line 15 or 22. Enter the result on line 21 or 35. This is **adjusted gross income** and is often referred to as "AGI." Adjusted gross income is used to compute some limitations, such as the medical and dental deduction on Schedule A and the credit for child and dependent care expenses.

► ► SUMMING UP THIS LESSON ◀ ◀

- An adjustment is an amount subtracted from total income.
 - The result is adjusted gross income.
- Adjustments covered in the VITA program are:
 - **▶** Educator expenses
 - ► Contributions to a traditional IRA
 - ► Student loan interest deduction
 - ► Tuition and fees paid
 - ➤ One-half of self-employment tax paid (volunteers trained to prepare Schedules C-EZ and SE can assist taxpayers claiming this adjustment)
 - ► Penalty on early withdrawal of savings
 - ► Alimony paid
 - ▶ Jury duty pay given to employer
- The adjustments for traditional IRA contributions, student loan interest deduction, tuition and fees deduction, and educator expenses deduction can be claimed either on Form 1040A or Form 1040. The other adjustments can be claimed on Form 1040.
- Persons 70 1/2 years of age or older by the end of the tax year cannot make traditional IRA contributions for that tax year.
- Traditional IRA contrubutions generally cannot be more than the tapayer's taxable compensation or \$3,000 (\$3,500 if age 50 or older), whichever amount is smaller.
- Individuals who are not covered by retirement plans at work may make deductible IRA contributions regardless of their modified adjusted gross income. Taxpayers who are covered by retirement plans at work may deduct all, part, or none of their traditional IRA contributions depending on their modified adjusted gross income and filing status.
- Taxpayers may be subject to additional tax for contributing more to a traditional IRA than is allowed, making traditional IRA withdrawals before age 59 1/2, and not withdrawing enough traditional IRA funds after age 70 1/2.

ADJUSTMENTS Answers to Exercises

Exercise 1

- (A) Yes; alimony is considered compensation for traditional IRA purposes.
- (B) Yes; Mary is under 70 1/2.
- (C) No; Carla has no compensation for traditional IRA purposes.
- (D) \$1,250; Because her total taxable compensation is less than \$3,500.

Exercise 2

- (A) Yes; all of her contribution up to \$3,000 is deductible because their combined modified adjusted gross income is not more than \$150,000.
- (B) Yes; all of it is deductible because her modified adjusted gross income is less than \$34,000.
- (C) Richard may not deduct any of his contribution because his modified adjusted gross income is at least \$10,000. Lynn will be able to deduct all of her IRA contribution because she is not covered by an employer-sponsored retirement plan.

Exercise 3

- (A) \$1,854
- (B) \$750
- (C) 1. \$2,000
 - 2. \$400

STANDARD AND ITEMIZED DEDUCTIONS, AND TAX COMPUTATION

Introduction and Objectives

In this lesson you will learn about the standard deduction, itemized deductions and tax computations. You will learn which expenses can be included in itemized deductions. You will also learn when the taxpayer will use the tax tables and the Capital Gains Worksheet to compute their total tax.

After completing this lesson you should be able to:

- Select the correct standard deduction.
- Calculate and accurately report itemized deductions on Schedule A.
- Determine the miscellaneous deductions reported on Schedule A, line 27.
- Use the Capital Gain Tax Worksheet to calculate tax.
- Accurately calculate and report tax liability.

STANDARD DEDUCTION

The **standard deduction** depends on:

- the taxpayer's filing status,
- whether the taxpayer (or the taxpayer's spouse) is 65 or older and/or blind, and
- whether the taxpayer can be claimed as a dependent on another taxpayer's return.

Based on the taxpayer's situation, you will figure the standard deduction by using one of the following:

- Standard deduction amount for the appropriate filing status from the appropriate tax form,
- Standard Deduction Chart for People Age 65 or Older or Blind, or
- Standard Deduction Worksheet for Dependents.

Tax Tips *******

The charts showing the standard deduction amounts are included in the IRS Volunteer Quick Reference Guide, which is part of your Publication 678 Package.

TAX TIPS

Be sure to check the appropriate boxes on line 5, Form 1040EZ. lines **23a and 23b. Form** 1040A, or lines 37a/37b, Form 1040. Failure to do so could generate an **IRS** notice and may delay processing of the return.

Example 1

Bob is 55 years old and is married to Janice, age 50. If they are filing a joint return and neither is blind, they can enter \$7,850 on either Form 1040 or Form 1040A for their standard deduction amount.

Example 2

John is 73 years old, blind, and files a single tax return. To find his standard deduction, use the Standard Deduction Chart for People Age 65 or Older or Blind. His standard deduction is \$7,000.

Personal Exemption in Connection With Standard Deduction on Form 1040EZ

If the taxpayer (or his or her spouse, if married filing a joint return) can be claimed as a dependent on another taxpayer's return, check the Yes box on line 5 of the Form 1040EZ. To fill in the amount on line 5 for this taxpayer, you must then turn the form over and complete the worksheet (the Exhibit shows a blank worksheet from Form 1040EZ, page 2).

If the taxpayer (or his or her spouse, if filing a joint return) cannot be claimed as a dependent on another taxpayer's return, check the *No* box on line 5. Enter on line 5 the amount shown below that applies to the taxpayer (and spouse, if married filing jointly).

A. Single, enter \$7,700. This is the total of the taxpayer's standard deduction (\$4,700) and personal exemption (\$3,000).

Exhibit 1 Form 1040EZ, Page 2

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

J 1 / 1	\ 1 \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \	
A. Amount, if any, from line 1 on front		
	+ 250.00 Enter total ►	· A
B. Minimum standard deduction		. B. 750.00
C. Enter the larger of line A or line B l	nere	. C.
D. Maximum standard deduction. If sin enter \$7,850		. D
E. Enter the smaller of line C or line D deduction	•	. E
F. Exemption amount.)
• If single, enter -0		
• If married and—		F.
-both you and your spouse can be cl	aimed as dependents, enter -0	
-only one of you can be claimed as a	a dependent, enter \$3,000.	J
G. Add lines E and F. Enter the total he	re and on line 5 on the front.	. G
checked "No" on line 5 because no on	e can claim you (or your spous	e if married) as a
dent, enter on line 5 the amount shown b	pelow that applies to you.	

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

B. Married, enter \$13,850. This is the total of the taxpayer's and spouse's standard deduction (\$7,850), exemption for the taxpayer (\$3,000), and exemption for the taxpayer's spouse (\$3,000).

Exercise 1

- **A.** James is 37 years old. He has two children who live with him and he files as head of household. What is James' standard deduction?
- **B.** Malcom is 37 years old. He was divorced in 2002. He is blind and has no dependent children. What is Malcom's standard deduction?
- **C.** Carl is 67 years old and married to Sue, who is 59 years old. Neither is blind. If they file a joint return, what is their standard deduction?
- **D.** If they are filing separate returns, what is Carl's standard deduction?
- **E.** If they are filing separate returns, what is Sue's standard deduction?
- **F.** Shirley is 15 years old and is claimed as a dependent on her parents' tax return. She earned \$1,500 during the summer and deposited it all into her savings account, where she earned \$40 in interest. What is her standard deduction?

POTENTIAL PITFALLS



Entering an incorrect standard
deduction amount
is a frequently
made error on tax
returns. Take care
to report the correct
standard deduction
amount.

TAX TIPS

A married taxpayer who files a separate return and whose spouse itemizes deductions will usually find it more beneficial to itemize deductions than to take the standard deduction of zero.

ITEMIZED DEDUCTIONS

Taxpayers can either claim the standard deduction or itemize their deductions. Both the standard deduction and itemized deductions reduce adjusted gross income. Most taxpayers choose the larger of their itemized deductions or their standard deduction. However, there are some exceptions:

- A married taxpayer filing a separate return cannot claim the standard deduction if the taxpayer's spouse itemizes deductions, and
- Nonresident aliens cannot claim the standard deduction.

For state tax purposes, it may be beneficial for some taxpayers to itemize deductions even if their total deductions are less than their standard deduction. If they do choose to itemize their deductions, enter "IE" (itemized elected) next to line 38 on Form 1040.

When itemizing, you should complete the taxpayer's return through line 36 of Form 1040. Then figure itemized deductions on Schedule A.

POTENTIAL PITFALLS



Explain to taxpayers that they can only deduct expenses in the year they are paid. They cannot deduct expenses that are owed but not paid.

● Person

Person \longrightarrow

If you believe that a specific expense is not deductible, but a taxpayer insists that it is, politely refer the taxpayer to a paid professional tax preparer. The taxpayer may be correct. However, you should not deduct an expense unless you are absolutely sure that it qualifies as an itemized deduction.

Medical and Dental Expenses

Claim medical and dental expenses paid in 2002 on lines 1 through 4 of Schedule A. Include expenses incurred for:

- the taxpayer and spouse,
- dependents claimed on the return, and
- others who could have been claimed as dependents except that they had gross income of \$3,000 or more, or they filed a joint return.

If a child of divorced or separated parents is claimed as a dependent on either parent's return, each parent may deduct the medical expenses that he or she pays for the child.

Deductible expenses include:

- Prescription medicines and drugs (including insulin)
- Medical, dental, and nursing care, including amounts paid for unreimbursed qualified long-term care services
- Medical and hospital insurance premiums, including amounts paid for eligible long-term care (subject to certain limitations based on the insured person's age see table later.)
- Prescription eyeglasses, hearing aids, crutches, wheelchairs, braces, and guide dogs
- Transportation for medical care at 13 cents a mile, or actual out-of-pocket expenses, plus parking fees and tolls
- Certain lodging expenses
- Certain home improvements made for medical care purposes or to make the home suitable for a disabled person
- Medicare A premiums for persons not enrolled in Social Security
- Medicare B
- Certain weight-loss programs to treat disease diagnosed by a physician, including obesity
- Unreimbursed costs of smoking-cessation programs, including the cost of prescription drugs designed to alleviate nicotine withdrawal
- Expenses for admission and transportation to a medical conference relating to the chronic disease of a dependent (if the costs are primarily for and essential to the medical care of the dependent).

Total medical and dental expenses must exceed 7.5 percent of a tax-payer's adjusted gross income (Form 1040, line 35) for Schedule A deduction.

Nondeductible expenses include:

- Medical expenses paid from a medical savings account (MSA). [Refer taxpayers with MSAs to Publication 969, *Medical Savings Accounts (MSAs)*, Publication 502, *Medical and Dental Expenses*, and a paid professional tax preparer.]
- Payroll tax paid for Medicare A
- Life insurance policy premiums
- Babysitting, child care, and nursing care for a healthy baby
- Illegal drugs
- Nonprescription drugs or medicines
- The cost of purchasing diet food items
- Nonprescription nicotine gum and patches designed to stop smoking
- Funeral, burial, or cremation costs
- Unnecessary cosmetic surgery (surgery that does not correct a congenital abnormality or an abnormality caused by injury or disease)
- Income protection policies, including nursing home policy premiums, if the policy ensures a maximum out-of-pocket expense per day
- Meals and lodging while attending a medical conference relating to the chronic disease of a dependent.

Eligible Long-Term Care Premiums

Attained age before the close of the taxable year:

40 years or less	\$	240
More than 40, but not more than 50	\$	450
More than 50, but not more than 60	\$	900
More than 60, but not more than 70	\$2	,390
More than 70	\$2	,990

These figures should always be checked against the figures in the instructions for the Form 1040, Schedule A.

Exercise 2

Sam and Paula Fordham file a joint return. Sam's social security number is 000-00-8612. Their adjusted gross income is \$40,000. They paid the following medical bills:

Unreimbursed doctors' bills	\$ 500
Unreimbursed orthodontist bill for braces	1,200
Hospital insurance premiums	300
Life insurance premiums	500
Unreimbursed prescription medicines	100
Vitamins	70
Hospital bill (before deducting \$1,000	
reimbursed by insurance company)	2,000
Smoking cessation program	150

Complete the *Medical and Dental Expenses* section of Schedule A for the Fordham family.

Exhibit 2 Schedule A OMB No. 1545-0074 **SCHEDULES A&B** Schedule A-Itemized Deductions (Form 1040) (Schedule B is on back) Attachment Sequence No. 07 ► Attach to Form 1040. ► See Instructions for Schedules A and B (Form 1040). Internal Revenue Service Name(s) shown on Form 1040 Your social security number Medical Caution. Do not include expenses reimbursed or paid by others. 1 and Medical and dental expenses (see page A-2) . . Dental Enter amount from Form 1040, line 36 2 **Expenses** 3 Multiply line 2 above by 7.5% (.075) Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-

Taxes

To be deductible, a tax must be imposed on and paid by the taxpayer. Taxpayers **cannot** deduct:

- a tax that they do not owe, but pay for someone else,
- **a** tax that they owe, but someone else pays, or
- **a** tax that was not paid in 2002.

Report deductible taxes on lines 5 through 9 of Schedule A.

State, Local, and Foreign Income Taxes—Taxpayers can deduct income taxes paid to a state or local government or to a foreign government or any of its subdivisions. These taxes include tax withheld, estimated payments, and tax paid for an earlier year.

Real Estate Taxes—State, local, or foreign taxes on real property, such as the taxpayer's house or land, are deductible. Real estate taxes are deductible when paid. If the taxes are paid with a mortgage payment and held in escrow, do not deduct the taxes until they are paid by the bank or mortgage lender.

Assessments to pave a street or install lighting or a sewer generally are not deductible.

Personal Property Tax—Taxes that state and local governments charge on the value of personal property are deductible. A portion of the cost of personal vehicle registration may fall in this category.

Nondeductible Taxes—Many federal, state, and local government taxes are not deductible. The following taxes are not deductible:

- General sales tax
- Federal taxes—income tax, social security (FICA), Medicare, railroad retirement tax, gift tax, and excise taxes or customs duties
- Hunting licenses and dog licenses
- Water and sewer taxes
- Taxes on alcoholic beverages, cigarettes, and tobacco
- State, local, and federal taxes on gasoline, diesel, and other motor fuels used in a nonbusiness vehicle
- Utility taxes—telephone, gas, electricity, etc.

Interest

Interest is the amount that is paid in order to borrow money. Only taxpayers who are legally liable for the debt can deduct the interest in the year it is paid or accrued. Interest expenses are reported on lines 10 through 14 of Schedule A.

Home Mortgage Interest—The amount of mortgage interest that a taxpayer can deduct depends on the:

- date of the loan,
- amount of the loan, and
- use of the proceeds of the loan.

If the mortgage debt was incurred on or before October 13, 1987, and was secured by a main or second home, the interest on that debt is fully deductible, regardless of the amount of the loan or the use of the loan proceeds.

If the mortgage debt was incurred after October 13, 1987, and was secured by a main or second home, the interest is fully deductible if:

- the loans plus any grandfathered debt do not exceed \$1 million (\$500,000 if married filing separate returns), and
- the proceeds were used to buy, build, or improve the home or homes.

SPECIAL POPULATIONS



Members of the clergy and military personnel can deduct real estate taxes even if they receive a housing allowance that is excluded from income. Also, they can deduct allowable mortgage interest even if the interest was paid from a nontaxable housing allowance.

In addition to loans used to buy, build, or improve a main or second home, taxpayers can deduct interest on other loans secured by a main or second home, regardless of the use of the proceeds, if:

- the total of these loans does not exceed \$100,000 (\$50,000 if married filing separate returns), and
- the total amount of the secured debt is not more than the home's fair market value minus any outstanding acquisition debt and any grandfathered debt on the home.

Points. Certain charges paid by a borrower and/or a seller to a lender to secure a loan are called points. They are also called loan origination fees (including VA and FHA loan origination fees), maximum loan charges, premium charges, loan discount, or discount points.

Points paid only for the use of money are considered prepaid interest. This interest, even if it qualifies as home mortgage interest, must be spread over the life of the mortgage and is considered paid and deductible over that period unless it meets the following exception.

Exception. A taxpayer may fully deduct points in the year he or she pays them only if all of the following conditions apply.

- The taxpayer itemizes deductions.
- The taxpayer's loan is secured by his or her main home. (The main home is the one the taxpayer lives in most of the time.)
- Paying points is an established business practice in the area where the loan was made.
- The points paid were not more than the points generally charged in that area.
- The taxpayer uses the cash method of accounting. (The cash method means that the taxpayer reports income in the year received and deducts expenses in the year paid.)
- The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
- The taxpayer uses his or her loan to buy or build his or her main home.
- The points were computed as a percentage of the principal amount of the mortgage.
- The amount is clearly shown on the settlement statement (such as Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either the taxpayer's or the seller's funds.
- The funds the taxpayer provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds the taxpayer provided do not have

TAX TIPS********

If the taxpayer does not meet the exception that allows him or her to deduct the full amount of points in the year paid, refer the taxpayer to a paid professional tax preparer.

Tax Tips *******

Taxpayers that meet the exception may choose to either fully deduct points in the year paid on a home mortgage or they may choose to amortize such points over the life of the loan, beginning in the year the loan was acquired. In either case, the points are deductible as interest on Schedule A (Form 1040).

to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds the taxpayer paid at or before closing for any purpose. The taxpayer cannot have borrowed these funds from his or her lender or mortgage broker.

Charges by the lender for specific services, such as appraisal fees, preparation costs, VA funding fees, or notary fees, may be called points. However, these charges are not considered interest and are not deductible.

Points paid by the seller are deductible as interest by the buyer.

Points paid to refinance a mortgage are generally not deductible in full in the year the taxpayer paid them (unless they are paid in connection with the improvement of a main home and the first seven statements, discussed earlier under *Exception*, are true).

Points paid in excess of those generally charged in the area and points paid to refinance a mortgage can be deducted over the life of the mortgage. Deduct points reported to the taxpayer on Form 1098 on line 10 of Schedule A (Form 1040). Deduct points not reported to the taxpayer on Form 1098 on line 12 of Schedule A (Form 1040).

Investment Interest. Interest that is paid on money borrowed to buy or carry property held for investment is called **investment interest**. Taxpayers with investment interest expense that exceeds investment income (interest and ordinary dividend income) should see a paid professional tax preparer.

Interest that cannot be deducted. Interest that cannot be deducted includes:

- Interest on car loans where the car is used for personal use and other personal loans,
- Credit investigation fees,
- Loan fees; aid for services necessary to get a loan,
- Interest on a debt the taxpayer is not legally liable to pay, and
- Finance charges on credit card purchases of personal items.

POTENTIAL
PITFALLS
Personal interest
cannot be claimed
as an itemized
deduction. Personal
interest includes
interest on car
loans, credit card
balances, and
installment-plan
loans that are
incurred for personal use or for personal expenses.

Exercise 3

John and Shannon file a joint return. During the year, they paid the bank \$2,180 of interest on their home mortgage that was re-ported to them on Form 1098 (all qualified), \$400 in credit card interest, \$300 on an installment loan, and \$2,000 on a car loan. Complete the Interest You Paid section of Schedule A for John and Shannon.

khibit 3					Schedule A
Interest You Paid (See page A-3.)	10 11	Home mortgage interest and points reported to you on Form 1098 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address	10		
Note. Personal interest is not	12	Points not reported to you on Form 1098. See page A-3 for special rules.	11		
deductible.	13 14	Investment interest. Attach Form 4952 if required. (See page A-3.)		14	

TAX TIPS ****

Taxpayers can deduct contributions to a U.S. organization that transfers funds to a charitable foreign organization. This is true whether the U.S. organization controls the use of the funds or if the foreign organization is only an administrative arm of the **U.S.** organization.

Contributions

Taxpayers can deduct contributions to organizations that are:

- Organized and operated exclusively for religious, charitable, educational, scientific, or literary purposes,
- Organizations that work to prevent cruelty to children or animals, and
- Organizations that foster national or international amateur sports competition if they do not provide athletic facilities or equipment.

To be deductible, contributions must be made to an organization, not an individual. Qualifying organizations include:

- Churches, synagogues, temples, mosques, Salvation Army, Red Cross, CARE, United Way, Boy Scouts, Girl Scouts, World Wildlife Fund, etc.,
- Fraternal orders (if used for the purposes listed above),
- Nonprofit schools and hospitals,
- Nonprofit medical research organizations,
- Veterans' groups and certain cultural groups, and
- Federal, state, and local governments (if the gifts are exclusively for public purposes).

Nonqualifying organizations include:

- Business organizations, such as the Chamber of Commerce,
- Civic leagues and associations,
- Political organizations and candidates,

- Social clubs,
- Foreign organizations,
- Homeowners' associations, and
- Communist organizations.

Deductible items include:

- Money gifts,
- Dues, fees, and assessments paid to qualified organizations above the value of the benefits received (not country clubs or other social organizations),
- Fair market value of used clothing, furniture,
- Cost and upkeep of uniforms that have no general use but must be worn while performing donated services,
- Unreimbursed transportation expenses that relate directly to the services the taxpayer gave the qualified organization, including bus fare, parking fees, tolls, and either the actual cost of gas and oil or a standard mileage charge of 14 cents per mile, and
- The part of a contribution above the fair market value for items such as merchandise and tickets to charity balls or sporting events.

Nondeductible items include:

- Cost of raffle, bingo, or lottery tickets,
- Tuition,
- Value of a person's time or service,
- Blood donated to a blood bank or the Red Cross,
- Car depreciation, insurance, general repairs, or maintenance,
- Direct contributions to an individual,
- Sickness or burial expenses for members of a fraternal society, and
- The part of a contribution that personally benefits the taxpayer (such as the fair market value of the meal eaten at a charity dinner).

Report cash and check contributions on Schedule A, line 15. Contributions other than cash or check are entered on line 16. Taxpayers with noncash contributions exceeding \$500 should see a paid professional tax preparer.

The taxpayer must keep records to prove the amount of the cash and noncash contributions he or she makes during the year.

A taxpayer can claim a deduction for any single contribution of \$250 or more **only** if he or she has a written acknowledgment of the contribution from the qualifying organization. You do not have to see the written acknowledgement, but you should ask the taxpayer if they have one.

TAX TIPS

Taxpayers can also deduct contributions for disaster relief, for example, flood or hurricane relief, to a qualified organization. However, a taxpayer cannot deduct contributions for relief to a particular family or individual.

ALERT



If the taxpayer makes a contribution to a qualifying organization that is more than \$75 and is partly for goods or services, the qualifying organization must give the taxpayer a written statement. For more information, see Publication 526, Charitable Contributions.

Exercise 4

Rose contributed \$600 to St. Martin's Church (church gave letter verifying amount), \$32 to the Girl Scouts, and \$40 to a family whose house burned. She purchased \$50 worth of lottery tickets and spent \$100 playing bingo at her church. She donated used furniture with a fair market value of \$200 to Goodwill.

Complete the Gifts to Charity section of Schedule A for Rose.

Exhibit 4 Schedule A

Gifts to Charity	15	Gifts by cash or check. If you made any gift of \$250 or more, see page A-4	15			
If you made a gift and got a	16	Other than by cash or check. If any gift of \$250 or more, see page A-4. You must attach Form 8283 if over \$500	16			
benefit for it, see page A-4.	17 18	Carryover from prior year		 <u> </u>	18	

TAX TIPS

Do not try to compute the deductible casualty or theft loss for taxpayers. This deduction is complex, with many rules and exceptions. Refer the taxpayer to a paid professional tax preparer.

Casualty and Theft Losses

A casualty occurs when property is damaged as a result of a sudden, unexpected, or unusual event such as fire, storm, shipwreck, flood, earthquake, or automobile accident. Theft is the unlawful taking and removing of money or property with the intent to deprive the owner of it. Theft does not include the mere disappearance of money or property.

A casualty or theft may result in a gain if the insurance proceeds or other reimbursements exceed the adjusted basis of destroyed or stolen property.

Usually, however, a casualty or theft results in a loss. Part of a casualty or theft loss may be deductible if the taxpayer can prove that the casualty or theft occurred to property that the taxpayer owned. The taxpayer must also prove the dollar amount of the loss.

Miscellaneous Itemized Deductions

Certain employee expenses, expenses of producing income, and other qualifying expenses are reported as miscellaneous itemized deductions on Schedule A. Miscellaneous itemized deductions that exceed 2% of adjusted gross income are deductible. There are some miscellaneous itemized deductions that are deductible, regardless of a taxpayer's adjusted gross income.

Examples of deductions that are subject to the 2% limit and that are reported on lines 20 through 26 of Schedule A are:

- Union dues and fees,
- Professional society dues,
- Uniforms not adaptable to general use,
- Small tools and supplies,
- Professional books, magazines, journals,

- Employment-related educational expenses,
- Expenses of looking for a new job,
- Investment counsel fees,
- Investment expenses,
- Tax counsel and assistance,
- Fees paid to an IRA custodian, and
- Safe deposit box rental for investment documents.

Examples of deductions that are not subject to the 2% limit and that are reported on line 27 of Schedule A are:

- Gambling losses to the extent of gambling winnings, and
- Work-related expenses for an individual with a disability, such as attendant-care services at the individual's place of work, that are necessary for the person to work.

Nondeductible expenses include:

- Burial or funeral expenses,
- Wedding expenses,
- Fees and licenses, such as car and marriage licenses and dog tags,
- Fines and penalties, such as parking tickets,
- Home repairs, insurance, and rent,
- Illegal bribes and kickbacks,
- Insurance premiums (except medical insurance premiums),
- Losses from the sale of a taxpayer's home, furniture, or personal car,
- Lost or misplaced cash or property,
- Personal legal expenses, and
- Commuting expenses to and from work.

Exercise 5

Roberts's adjusted gross income is \$20,000. He wants to deduct the following items on his tax return:

2002 income tax preparation fee	\$100
Safe deposit box rental (used to keep bonds)	75
Life insurance premiums	300
Investment expenses	70
Loss on sale of personal home	800
Investment journals and newsletters	250
Investment advisory fees	200
Attorney fees for preparation of will	100

Complete Robert's Schedule A, lines 20 through 26.

nibit 5				Schedule
Job Expenses and Most Other Miscellaneous Deductions		Unreimbursed employee expenses—job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶	20	
	21	Tax preparation fees	21	
(See page A-5 for expenses to deduct here.)	22	Other expenses—investment, safe deposit box, etc. List type and amount ▶	22	
	23	Add lines 20 through 22	23	
	24	Enter amount from Form 1040, line 36 24		
	25	Multiply line 24 above by 2% (.02)		
	26	Subtract line 25 from line 23. If line 25 is more than line	23, enter -0 26	

Tax Tips

There is a limit on total itemized deductions for tax-payers with adjusted gross income greater than \$137,300 (\$68,650, if married filing separately.)

TOTAL ITEMIZED DEDUCTIONS

Schedule A, line 28, is *Total Itemized Deductions*. It is the sum of lines 4, 9, 14, 18, 19, 26, and 27.

Compare the amount on line 28 to the standard deduction, and enter the larger of the two on Form 1040, line 38.

Exercise 6

Seth A. and Karen Yale's adjusted gross income is \$28,000. Seth's social security number is 000-00-1039. They gave you a list of their itemized deductions. They received no insurance reimbursement for medical expenses. They purchased their home in 1989, and the mortgage is held by a commercial mortgage company. They have not refinanced the mortgage or increased the principal balance since they bought their home. They are both under age 65 and not blind. Neither can be claimed as a dependent by another taxpayer.

Medical	expenses:
---------	-----------

Medical insurance premiums	\$480
Hospital	600
Doctors and dentists	820
Vitamins	75
Prescription drugs	300
Insulin	120

Taxes:

State income tax	\$1,200
Federal income tax	2,400
Real estate tax	780

Interest:

Interest on mortgage (reported on Form 1098)	\$4,500
Car loan	900
Credit cards	102

Contributions:

Church (gave Yales' letter verifying this amount)	\$850
Bingo costs	60
American Cancer Society	130
Canned goods donated to a food drive	15
Fair market value of donated used clothing	60

Miscellaneous:

Union dues	\$90
IRA custodial fee	10
Traffic fine	70
Investment expenses	20

Complete Seth and Karen's Schedule A.

Exhibit 6 Schedule A

(Schedule B is on back) Department of the Treasury Internal Revenue Service (99) Name(s) shown on Form 1040 Medical Caution. Do not include expenses reimbursed or paid by others. and 1 Medical and dental expenses (see page A-2) 1 Dental 2 Enter amount from Form 1040, line 36 2 Expenses 3 Multiply line 2 above by 7.5% (.075) 3 State and local income taxes 5	
Medical and dental expenses (see page A-2)	
Medical Caution. Do not include expenses reimbursed or paid by others. Medical and dental expenses (see page A-2) Dental Expenses Multiply line 2 above by 7.5% (.075) Subtract line 3 from line 1. If line 3 is more than line 1, enter -04	ity numbe
Tand 1 Medical and dental expenses (see page A-2) 2 Enter amount from Form 1040, line 36 2 Expenses 3 Multiply line 2 above by 7.5% (.075) 4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0	
Dental 2 Enter amount from Form 1040, line 36 2 Expenses 3 Multiply line 2 above by 7.5% (.075)	
Subtract line 3 from line 1. If line 3 is more than line 1, enter -0	
4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0	
5 Olds and backing a second and	
dates four of otate and local income taxes	
Paid 6 Real estate taxes (see page A-2)	I .
See 7 Personal property taxes	
age A-2.) 8 Other taxes. List type and amount ▶	
9 Add lines 5 through 8	
nterest 10 Home mortgage interest and points reported to you on Form 1098	
You Paid 11 Home mortgage interest not reported to you on Form 1098. If paid	
See to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address	
and show that person's name, identifying no., and address	
lote.	
Personal nterest is for special rules	
leductible. 13 Investment interest. Attach Form 4952 if required. (See page A-3.)	
14 Add lines 10 through 13	
Charity	
f you made a 16 Other than by cash or check. If any gift of \$250 or more, gift and got a see page A-4. You must attach Form 8283 if over \$500	
penefit for it, 17 Carryover from prior year	
Table 18 Add lines 15 through 17	
Theft Losses 19 Casualty or theft loss(es). Attach Form 4684. (See page A-5.)	
lob Expenses 20 Unreimbursed employee expenses—job travel, union	
and Most dues, job education, etc. You must attach Form 2106	
Other or 2106-EZ if required. (See page A-5.) ►	
Odustions 20	
21 Tax preparation fees	
See 22 Other expenses—investment, safe deposit box, etc. List	
page A-5 for type and amount ▶	
expenses to 22 deduct here.)	
23 Add lines 20 through 22	
24 Enter amount from Form 1040, line 36 24 25 Multiply line 24 above by 2% (.02)	
26 Subtract line 25 from line 23. If line 25 is more than line 23, enter -0	
Other 27 Other—from list on page A-6. List type and amount ▶	
Miscellaneous Deductions 27	
Total 28 Is Form 1040, line 36, over \$137,300 (over \$68,650 if married filing separately)?	
temized No. Your deduction is not limited. Add the amounts in the far right column	
Deductions for lines 4 through 27. Also, enter this amount on Form 1040, line 38. ▶ 28	,,,,,,
☐ Yes. Your deduction may be limited. See page A-6 for the amount to enter.	
for Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11330X Schedule A (Form	

TAXABLE INCOME COMPUTATION

Once you have determined the standard deduction, compare it to the total itemized deductions. In most cases, you will enter the larger of the two amounts on Form 1040, line 38. Subtract line 38 from line 36 and enter the result on line 39. Then subtract the exemption deduction (line 40) to compute the taxable income.

If the taxpayer has capital gain distributions that are reported directly on Form 1040 or Form 1040A, the taxpayer should use the Capital Gain Tax Worksheet to determine if the tax is less. The taxpayer should:

- Check the box next to line 13, Form 1040 and
- Use the Capital Gain Tax Worksheet (Exhibit) from either the Form 1040A or 1040 instruction booklet to compute tax.

Example 8

Marjorie is a single taxpayer with taxable income of \$46,250. She files Form 1040 and does not have to file a Schedule D. In 2002, she received capital gain distributions of \$798 from XYZ Investments. Marjorie pays less tax by using Capital Gain Tax Worksheet (Exhibit 3).

Exhibit 7

Marjorie's Capital Gain Tax Worksheet

Сар	ital Gain Tax Worksheet—Line 42	Keep for Your Records
Be	fore you begin: √ Be sure you do not have to file Schedule D (see the instructions for Form 1040, line 13, on page 23). √ Be sure you checked the box on line 13 of Form 1040.	#
1.	Enter the amount from Form 1040, line 41	
2.	Enter the amount from Form 1040, line 13	
3.	Subtract line 2 from line 1. If zero or less, enter -0	
4.	Figure the tax on the amount on line 3. Use the Tax Table or Tax Rate Schedules, whichever applies	4. 9,124
5.	Enter the smaller of:	
	• The amount on line 1 or	
	• \$27,950 if single; \$46,700 if married filing jointly or qualifying widow(er); \$23,350 if married filing separately; or \$37,450 if head of household.	
6.	Is the amount on line 3 equal to or more than the amount on line 5?	
	🗵 Yes. Leave lines 6 through 8 blank; go to line 9 and check the "No" box.	
	□ No. Enter the amount from line 3	
7.	Subtract line 6 from line 5	
8.	Multiply line 7 by 10% (.10)	8
9.	Are the amounts on lines 2 and 7 the same?	
	☐ Yes. Leave lines 9 through 12 blank; go to line 13.	
	☒ No. Enter the smaller of line 1 or line 2	
10.	Enter the amount, if any, from line 7	
11.	Subtract line 10 from line 9. If zero or less, enter -0	
12.	Multiply line 11 by 20% (.20)	12. 160
13.	Add lines 4, 8, and 12	13. 9,284
14.	Figure the tax on the amount on line 1. Use the Tax Table or Tax Rate Schedules, whichever applies	149,344
15.	Tax on all taxable income (including capital gain distributions). Enter the smaller of line 13 or line 14 here and on Form 1040, line 42	15. 9,284

TAX TIPS

The Tax Table for Form 1040 is included in the Tax Forms Booklet Appendix.

Tax Tips *******

To reduce errors when finding the amount of tax in the Tax Table, look up the tax a second time after completing the return.

TAX TIPS

Always read the column heading before finding the tax in the Tax Tables.

FINDING THE TAX

Taxpayers with taxable income of less than \$100,000 use the Tax Table to find their tax. However, children under 14 years of age who have more than \$1,500 of investment income (interest, dividends, etc.) might not be able to use the Tax Table. Their income might have to be taxed at the parents' tax rate. These taxpayers should be referred to a paid professional tax preparer.

The Tax Table is in the instruction booklet for the tax forms. The tax is based on the person's filing status and taxable income. To find the tax, use the **taxable income** from the tax forms (1040EZ, line 6; 1040A, line 27; and 1040, line 41), and:

- locate the income bracket for the taxable income.
- read across that line until you reach the column for the appropriate filing status, and
- find the amount where the taxable income and filing status meet. This is the tax.

If the taxable income is the same as the ending amount in an income bracket, go to the next bracket to find the tax.

Qualifying widows(ers) use the married filing jointly column.

Enter the tax on Form 1040EZ, line 10, Form 1040A, line 28, or Form 1040, line 42.

Double check the amount entered. **Common errors** include:

- Using the wrong standard deduction,
- Incorrectly figuring the exemption amount,
- Using an amount other than taxable income to find the tax,
- Picking up the wrong number from the Tax Table, and
- Transposing the numbers when entering the tax amount.

▶▶ SUMMING UP THIS LESSON ◀◀

Both the standard deduction (or total itemized deductions, if greater) and exemption amounts are subtracted from adjusted gross income to arrive at taxable income.

The standard deduction depends upon:

- ▶ filing status,
- ➤ age, eyesight, and
- whether the taxpayer can be claimed as a dependent on another taxpayer's return.

Determine the standard deduction by using the:

- ➤ Standard Deduction amount for the appropriate filing status from the appropriate tax form,
- ➤ Standard Deduction Chart for People Age 65 or Older or Blind, or
- ➤ Standard Deduction Worksheet for Dependents.

Itemized deductions are specifically allowed by law. Claim itemized deductions on Schedule A (Form 1040).

Itemized deductions include:

- ► Medical and dental expenses
- ▶ Taxes paid
- ► Home mortgage and certain investment interest paid
- ► Charitable contributions
- ► Casualty and theft losses
- ► Miscellaneous itemized deductions.

Medical and dental expenses that exceed 7.5 percent of adjusted gross income are deductible.

To be deductible as a charitable contribution, a donation of \$250 or more must be acknowledged in writing by the charitable organization that received the donation.

Most miscellaneous itemized deductions that exceed 2% of adjusted gross income are deductible. However, there are certain miscellaneous itemized deductions that are fully deductible, regardless of adjusted gross income.

If deducted investment interest expense exceeds investment income, refer the taxpayer to a paid professional tax preparer.

If you are uncertain whether an expense qualifies as a deduction, do not guess. Refer the taxpayer to a paid professional tax preparer.

▶▶ SUMMING UP THIS LESSON ◄◄

(Continued)

Most taxpayers compare their total itemized deductions to their standard deduction and enter the larger amount on Form 1040, line 38.

Do not use the Tax Table for taxpayers with taxable income of \$100,000 or more.

Common errors include:

- ▶ Using the wrong standard deduction,
- ► Incorrectly figuring the exemption amount,
- ▶ Using an amount other than taxable income to find the tax,
- ▶ Picking up the wrong number from the Tax Table, and
- Transposing the numbers when entering the tax amount.

Lesson 5

Standard and Itemized Deductions and Tax Computation

Answers to Exercises

Exercise 1

- (A) \$6,900
- (B) \$5,850
- (C) \$8,750
- (D) \$4,825
- (E) \$3,925
- (F) \$1,750

Exercise 2

Sam and Paula's Schedule A

SCHEDULE	S A&	Schedule A—Itemized Deductions	OMB No. 1545-0074
(Form 1040)	(Schedule B is on back)	2002	
Department of the T Internal Revenue Se		99) ► Attach to Form 1040. ► See Instructions for Schedules A and B (Form 1040).	Attachment Sequence No. 07
Name(s) shown o	n Form	1040	Your social security number
San	n ar	nd Paula Fordham	000 00 8612
Medical		Caution. Do not include expenses reimbursed or paid by others.	
and	1	Medical and dental expenses (see page A-2)	
Dental	2	Enter amount from Form 1040, line 36 2 40,000	
Expenses	3	Multiply line 2 above by 7.5% (.075)	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0	4 250

Exercise 3 John and Shannon's Schedule A 2,180 10 Home mortgage interest and points reported to you on Form 1098 Interest 10 You Paid Home mortgage interest not reported to you on Form 1098. If paid 11 to the person from whom you bought the home, see page A-3 (See page A-3.) and show that person's name, identifying no., and address 11 Note. Personal Points not reported to you on Form 1098. See page A-3 interest is 12 for special rules deductible. Investment interest. Attach Form 4952 if required. (See page A-3.) . . . 13 Add lines 10 through 13 2,180 14

Exercise 4

Line 15 \$632 Line 16 \$200 Line 18 \$832

Exercise 5 Robert's Schedule A Unreimbursed employee expenses—job travel, union Job Expenses 20 and Most dues, job education, etc. You must attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶ Other Miscellaneous **Deductions** 20 100 21 21 Other expenses—investment, safe deposit box, etc. List (See page A-5 for type and amount ▶..... expenses to 595 safe deposit box \$75; investment \$520 22 deduct here.) 695 Add lines 20 through 22 . . 23 23 Enter amount from Form 1040, line 36 24 24 400 25 25 Multiply line 24 above by 2% (.02) Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-295 26 26

STANDARD AND ITEMIZED LESSON 5 DEDUCTIONS AND TAX COMPUTATION

Answers to Exercises

SCHEDULES	S A&B	Schedule A—Itemized Deductions	1 '	OMB No. 1545-0074
(Form 1040)				୭ 0002
Department of the Tr		(Schedule B is on back)		Attachment
Name(s) shown or				Sequence No. 07 ocial security number
		Seth and Karen Yale		00 1039
Medical	C	Caution. Do not include expenses reimbursed or paid by others.		
and Dental		Medical and dental expenses (see page A-2) 1 2,320		
Expenses		inter amount from Form 1040, line 36 2 28,000 Multiply line 2 above by 7.5% (.075)		
		Subtract line 3 from line 1. If line 3 is more than line 1, enter -0	4	220
Taxes You	5 S	State and local income taxes		
Paid		Real estate taxes (see page A-2)		
(See page A-2.)		Personal property taxes,		
page A 2.)	•	officer taxes. List type and amount P		
	9 A	Add lines 5 through 8	9	1,980
Interest		lome mortgage interest and points reported to you on Form 1098 10 4,500		
You Paid		lome mortgage interest not reported to you on Form 1098. If paid		
(See page A-3.)		o the person from whom you bought the home, see page A-3 nd show that person's name, identifying no., and address ▶		
, ,	1			
Note.				
Personal interest is		Points not reported to you on Form 1098. See page A-3		
not deductible.		or special rules		
acauctible.	р	page A-3.)		
	14 A	add lines 10 through 13	14	4,500
Gifts to		Gifts by cash or check. If you made any gift of \$250 or		
Charity		nore, see page A-4		
If you made a gift and got a		Other than by cash or check. If any gift of \$250 or more, ee page A-4. You must attach Form 8283 if over \$500		
benefit for it, see page A-4.	17 C	Carryover from prior year		
	18 A	Add lines 15 through 17	18	1,055
Casualty and Theft Losses	19 C	Casualty or theft loss(es). Attach Form 4684. (See page A-5.)	19	
Job Expenses		Unreimbursed employee expenses—job travel, union		
and Most		lues, job education, etc. You must attach Form 2106		
Other	0	or 2106-EZ if required. (See page A-5.) ▶		
Miscellaneous Deductions		Union dues \$90 20 90		
Dennerion9		ax preparation fees		
(See		Other expenses—investment, safe deposit box, etc. List		
page A-5 for expenses to	t	ype and amount ► IRA custodial fee \$10;		
deduct here.)		Investment \$20 22 30 add lines 20 through 22 23 120		
	23 A 24 E	Add lines 20 through 22		
	24 E	Aultiply line 24 above by 2% (.02)		
		Subtract line 25 from line 23. If line 25 is more than line 23, enter -0	26	0
Other	27 C	Other—from list on page A-6. List type and amount		
Miscellaneous Deductions	-		27	
Total	28 Is	s Form 1040, line 36, over \$137,300 (over \$68,650 if married filing separately)?	21	
Itemized		No. Your deduction is not limited. Add the amounts in the far right column		
Deductions		for lines 4 through 27. Also, enter this amount on Form 1040, line 38.	28	7,755
		Yes. Your deduction may be limited. See page A-6 for the amount to enter.	\\\\\\\	

Cat. No. 11330X

Schedule A (Form 1040) 2002

For Paperwork Reduction Act Notice, see Form 1040 instructions.

CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS, MORTGAGE INTEREST, AND FOREIGN TAX CREDIT

Lesson 6

Introduction and Objectives

In this lesson you will learn about three "miscellaneous credits". The mortgage interest credit and the foreign tax credit are covered in this lesson. A new credit for qualified retirement savings has been added this year.

After completing this lesson you should be able to:

- Calculate the credit for qualified retirement savings contributions by using Form 8880.
- Accurately report the foreign tax credit if Form 1116 is not required.

Credits

A credit is a dollar-for-dollar reduction of the taxpayer's tax liability. A **refundable** credit can be greater than the tax. Taxpayers not only can have their tax reduced to zero; they can also receive a "refund" of excess credit. A **nonrefundable credit** can also be greater than the tax, but the nonrefundable credit can only reduce the tax to zero. Therefore, taxpayers will not receive a refund for any excess nonrefundable credit.

The Hope credit, the lifetime learning credit, the credit for child and dependent care expenses, the credit for the elderly or the disabled, the mortgage interest credit and the credit for qualified retirement savings contributions are nonrefundable credits.

The child tax credit is generally nonrefundable; but some taxpayers can qualify for the additional refundable child tax credit.

CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS

Beginning in 2002, if the taxpayer contributed to a retirement plan or an IRA, he or she may be eligible for the credit for qualified retirement savings contributions credit or saver's credit (a nonrefundable credit). The amount of the saver's credit is determined by the taxpayer's filing status, adjusted gross income, credit rate, and his or her qualified contributions.

The credit is reported on line 49 of Form 1040, or line 32 of Form 1040A.

To be eligible for the saver's credit, the taxpayer:

- Must be age 18 or older by the end of the tax year,
- Cannot be claimed on another person's tax return, and
- Cannot be a full-time student.

A **full-time student** is anyone who attends school full-time for some part of each of five calendar months of the year. The five months need not be consecutive. An individual is a full-time student if he or she is enrolled for the number of hours or courses the school considers as full-time attendance.

FIGURING THE CREDIT

The credit for qualified retirement savings contributions is figured by multiplying the **credit rate** by the lessor of the:

- Maximum allowable contribution (\$2,000), or
- Eligible contributions.

The credit rate is determined by using the following table.

IF your filing status is	AND your adjusted gross income is	THEN your credit rate is		
	Less than \$30,001	50%		
Married filing	Between \$30,001 and \$32,500	20%		
jointly	Between \$32,501 and \$50,000	10%		
	Over \$50,000	0		
	Less than \$22,501	50%		
Head of	Between \$22,501 and \$24,375	20%		
Household	Between \$24,376 and \$37,500	10%		
	Over \$37,500	0		
G: 1 3M · 1	Less than \$15,001	50%		
Single, Married filing separately,	Between \$15,001 and \$16,250	20%		
or qualifying widow(er)	Between \$16,251 and \$25,000	10%		
WIGOW(CI)	Over \$25,000	0		

Adjusted gross income is determined without regards to:

- The foreign income exclusion
- The foreign housing exclusion or deduction
- Income from sources within Guam, American Samoa, and the Northern Mariana Islands
- Income from Puerto Rico

Eligible contributions are determined by reducing the taxpayer's *qualified retirement savings contributions* by the following distributions that were received during the *testing period*.

- Any distribution, that is included in the taxpayer's gross income, from a qualified retirement plan, or from an eligible deferred compensation plan.
- Any distribution from a Roth IRA that is not a qualified rollover contribution.

If the distributions received by the taxpayer are for loans or for excess IRA contributions returned before the due date of the return, they are not used to reduce the taxpayer's qualified retirement savings contributions.

Qualified retirement savings contributions are contributions made to a traditional or Roth IRA and salary reduction contributions to a 401(k) plan (including a SIMPLE 401(k)), a tax-sheltered annuity (403(b)) plan, an eligible deferred compensation plan of a state or local government (457(b)) plan), a SIMPLE IRA plan, or a salary reduction SEP.

Qualified retirement savings contributions also include voluntary after-tax employee contributions to a tax-qualified retirement plan or a tax-sheltered annuity (403(b)) plan. For purposes of the credit, an employee contribution will be voluntary as long as it is not required as a condition of employment.

The *testing period* includes:

- The tax year,
- The two preceding tax years, and
- The period between the end of the tax year and the due date of the return (including extensions).

Example 1

Terry contributes \$3,000 to a 401(k) plan during 2002. In 2001, Terry withdrew \$500 from his IRA. In 2002, he withdrew \$900 from his IRA. Neither of these withdrawals were rolled over. In 2002, Terry's adjusted gross income was \$23,000 and his filing status was head of household. Based on these facts, Terry would figure his saver's credit as follows:

(Qualified retirement contributions – withdrawals) x credit rate (per table)

$$(\$3,000 - \$1,400) \times .20$$

 $\$1,600 \times .20 = \$320 \text{ saver's credit}$

The saver's credit can be figured on **Form 8880**, *Credit for Qualified Retirement Savings Contributions*.

Married filing jointly. If the taxpayer is married filing a joint return, he or she and his or her spouse may both use the credit. Both the taxpayer and spouse are eligible for a credit of the maximum annual contribution amount of \$2,000.

If the taxpayers file a joint return, the qualified contribution is reduced by the taxable distributions received by the taxpayer or the taxpayer's spouse if the taxpayers filed jointly for both:

- the year a distribution was made, and
- the year the credit is claimed.

Exercise 1

Jason is 22 and earned \$30,000 in 2002. He is single and contributed \$3,000 to his 401(k) plan at work. Is Jason eligible for the credit for qualified retirement savings contributions?

Exercise 2

Sally Jones (000-00-0088) is 32 and files as Head of Household. Her only income is wages of \$26,819. This year, she was able to contribute \$1,000 to her employer's 401(k) plan. She did not put any money in an IRA. Use Exhibit 1 to complete Sally's Form 8880 through line 10.

TAX TIPS

A copy of Form 8396,
Mortgage Interest
Credit can be found
in the Tax Forms
Booklet Appendix,
which is part of your
Publication 678
Package.

orm **8880**

Credit for Qualified Retirement Savings Contributions

OMB No. 1545-xxxx

2002
Attachment

Department of the Treasury Internal Revenue Service

► Attach to your tax return.

Attachment	
Sequence No.	129

Name(s) shown on return

Your social security number

Caution.	You	cannot	claim	thic	credit	if.

- Your adjusted gross income is over \$25,000 (\$37,500 if head of household; \$50,000 if married filing jointly);
- You were born after January 1, 1985;
- Someone else (such as your parent) claims you as a dependent for 2002; or
- You were a full-time student during 5 or more months in 2002.

						(a) You	1	(b) Your spou	ıse
1	Enter the am	ount contribut	ed to traditional and Ro	th IRAs for 2002	1				
2	qualified em	ployer plan for	reduction contributions 2002, plus any volunta						
3	Add lines 1 a	and 2 in colum			3				
4	from other of	qualified retirer ue date (includ	RA distributions, plus all nent plans, that were n ling extensions) of your	nade after 1999 a 2002 tax return (s	nd ee . 4				
5	Subtract line	4 from line 3 ii	n columns (a) and (b). If a	zero or less, enter -	.0- 5				
6	In each colu	mn, enter the	smaller of line 5 or \$2,0	00	. 6				
7	Add the amo	ounts on line 6	. If zero, stop ; you cann	ot claim the credit			7		
•			, , , 5						
8	Enter the am	nount from For	m 1040, line 36 (or Forn	n 1040A, line 22)*	8				
9	Enter the ap	plicable decim	al amount shown below	for your filing stat	us				
	If line	e 8 is	Enter on line 9		Single, Marr	· //			
	Over	But not over	Married filing jointly	Head of household	separate Qualifing w	· //			
		\$15,000	.50	.50	.50				
	\$15,000	\$16,250	.50	.50	.20				
	\$16,250	\$22,500	.50	.50	.10				
	\$22,500	\$24,375	.50	.20	.10		9	Χ.	
	\$24,375	\$25,000	.50	.10	.10				
	\$25,000	\$30,000	.50	.10	.00				
	\$30,000	\$32,500	.20	.10	.00				
	\$32,500	\$37,500	.10	.10	.00				
	\$37,500	\$50,000	.10	.00	.00				
	\$50,000		.00	.00	.00				
		Note: If line 9	is zero, stop ; you cann	ot claim the credit.					
10	Multiply line	7 by line 9					10		
11	Enter the am	•	m 1040, line 44 (or Forn		11				
12	Enter the total	al of your credi	ts from Form 1040, lines	s 45 through 48 (or					
13	Subtract line	12 from line 1	1. If line 12 is equal to o	r more than line 11	, stop ; you ca		13		
14	Credit for qu	ualified retiren	nent savings contributi ne 49 (or Form 1040A, li	ons. Enter the sma		or line 13	14		
	*See Pub. 970	for the amount	to enter if you are filing For	rm 2555, 2555-EZ, or	4563 or you ar	e excluding incom	e fron	n Puerto Rico.	
For	Paperwork R	eduction Act	Notice, see page 4.		Cat. No. 33394	0		Form 8880	(2002)

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TAX TIPS ******** A copy of Form 1116 can be found in the Tax Forms Booklet Appendix, which is part of your Publication 678 Package.

Mortgage Interest Credit

Taxpayers who hold qualified mortgage credit certificates under a qualified state or local government program may claim a credit for mortgage interest paid. The certificate must be for the taxpayer's main home. If the interest is paid to certain related parties (such as relatives), the credit cannot be claimed.

The credit is figured on Form 8396, *Mortgage Interest Credit*. Include the amount of the credit on Form 1040, line 52. Also, check box a on line 47 for Form 8396.

Any mortgage interest credit that the taxpayer cannot use in 2002 can be carried forward for up to three tax years. Figure the carryforward credit in Part II of Form 8396.

Reduce the mortgage interest deduction claimed on Schedule A, Form 1040, by the amount shown on line 3 of Form 8396.

Caution: If the taxpayer was issued (and used) a qualified mortgage credit certificate after 1990 for a home, the taxpayer may have to recapture (repay) all or part of the benefit if the taxpayer sells that home within 9 years. The recapture is figured on Form 8828, *Recapture of Federal Mortgage Subsidy*.

FOREIGN TAX CREDIT

If the taxpayer paid income, war profits, or excess profits taxes to any:

- Foreign country,
- U.S. possession, or
- Any political subdivision, or agency or instrumentality of the country or possession, he or she may be able to take a **Foreign Tax Credit** (FTC) for taxes paid.

To determine if the tax paid is eligible for the foreign tax credit, the taxpayer **may** need to consult a paid professional preparer.

Generally, to claim the FTC, a taxpayer is required to file Form 1116, Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual); however, the taxpayer does not have to file Form 1116 to take the credit if he or she meets all of the following requirements.

- All of the taxpayer's gross foreign source income is from interest and dividends that are reported on Form 1099-INT, or Form 1099-DIV (or substitute statement)
- If the taxpayer has dividend income from shares of stock, he or she held those shares for at least 16 days.
- The taxpayer is not filing Form 4563, *Exclusion of Income for Bona Fide Residents of American Samoa*, or excluding income from sources within Puerto Rico.
- The total of the taxpayer's foreign taxes is less than or equal to \$300 (\$600 if married filing jointly).
- All of the taxpayer's foreign taxes were:
 - Legally owed and not eligible for a refund, and
 - Paid to countries that are recognized by the United States and do not support terrorism.

For additional information, see the Instructions for Form 1116.

If the taxpayer meets all of the requirements listed above, enter the foreign tax credit on line 45 of Form 1040. Form 1116 is not required.

Example 2

Tabitha received a 1099-DIV that shows \$219 of foreign taxes (box 6) in 2002. According to Tabitha she paid no other foreign taxes. She can claim the \$219 on line 45 of Form 1040.

Exercise 3

Clyde comes to your site seeking help with his foreign tax credit. He is single and his 1099-DIVs show a total of \$423 of foreign tax. Does Clyde need Form 1116 to claim his credit?

CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS, MORTGAGE INTEREST, AND FOREIGN TAX CREDIT

Lesson 6

Answers to Exercises

Answers to Exercises

Exercise 1

No; Jason is not eligible for the credit because his income exceeds the threshold limit.

Exercise 2

See the completed Form 8880 on the next page.

Exercise 3

Yes, Clyde needs to complete a Form 1116 since his foreign taxes exceed \$300. Clyde will need to seek the assistance of a paid professional preparer. Form **8880**

Credit for Qualified Retirement Savings Contributions

► Attach to your tax return.

OMB No. 1545-xxxx

2002

Attachment
Seguence No. 129

Department of the Treasury Internal Revenue Service Name(s) shown on return

Sally Jones

Your social security number 000 00 0088

Caution. You cannot claim this credit if:

- Your adjusted gross income is over \$25,000 (\$37,500 if head of household; \$50,000 if married filing jointly);
- You were born after January 1, 1985;
- Someone else (such as your parent) claims you as a dependent for 2002; or
- You were a full-time student during 5 or more months in 2002.

							(a) You	(b) Your spouse
1	Enter the am	nount contribut	ed to traditional and Ro	th IRAs for 2002		1	0		
2			reduction contributions						
			2002, plus any volunta				1,000		
	instructions)	1.54.1			<i>P</i>	2			
3	Add lines 1 a	and 2 in colum	ns (a) and (b)			3	1,000		
4			RA distributions, plus all						
			nent plans, that were n						
	instructions)		ling extensions) of your			4	O		
5	,					5	1,000		
J	Subtract line	4 IIOIII IIIIe 3 II	ir columns (a) and (b). If a	zero or less, eriter	-0-		1,000		
6	In each colu	mn enter the	smaller of line 5 or \$2,0	00		6	1,000		
•	iii cacii colai	rimi, oritor the	5 mail of 11110 0 01 \$2,0		•		,		
7	Add the amo	ounts on line 6.	. If zero, stop ; you cann	ot claim the credit	t			7	1,000
			• • •						
8	Enter the am	nount from Fori	m 1040, line 36 (or Forn	n 1040A, line 22)*	8		26,819		
9	Enter the app	plicable decima	al amount shown below	for your filing stat	tus				
	If line	e 8 is	Enter on line 9		Single	- Ma	rried filing		
		But not	Married	Head of	•		te, or		
	Over	over	filing jointly	household	Qua	lifing	widow(er)		
		\$15,000	.50	.50		.50			
	\$15,000	\$16,250	.50	.50		.20			
	\$16,250	\$22,500	.50	.50		.10			
	\$22,500	\$24,375	.50	.20		.10	[7]	9	x.1
	\$24,375	\$25,000	.50	.10		.10			
	\$25,000	\$30,000	.50	.10		.00			
	\$30,000	\$32,500	.20	.10		.00			
	\$32,500	\$37,500	.10	.10		.00			
	\$37,500	\$50,000	.10	.00		.00			
	\$50,000		.00	.00		.00			
		Note: If line 9	is zero, stop ; you cann	ot claim the credit					
			, , , Juini						
0	Multiply line	7 by line 9						0	100
1	Enter the am	nount from For	m 1040, line 44 (or Forn	n 1040A, line 28)	11				
2	Enter the total	al of your credi	ts from Form 1040, lines	s 45 through 48 (or	r				
	Form 1040A	, lines 29 throu	ıgh 31)		12				
13	Subtract line	12 from line 1	1. If line 12 is equal to o	r more than line 1	1, stop;	you d			
							–	3	
14	•		nent savings contributi						
			ne 49 (or Form 1040A, li	,				4	
	*See Pub. 970	tor the amount	to enter if you are filing For	rm 2555, 2555-EZ, o	r 4563 o	r you	are excluding income	e from l	Puerto Rico.
or	Paperwork R	Reduction Act	Notice, see page 4.		Cat. N	o. 3339	940		Form 8880 (2002)

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S	TUDENT NOTES	
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Finishing the Return

Lesson 7

Introduction and Objectives

In this lesson you will learn how to report federal income tax payments and figure the overpayment or balance due. You will also learn how to determine if estimated taxes should be paid. Additionally, you will learn how to finish the return and have the taxpayer sign the return.

Please pay close attention to the section about identifying the returns that you work on. It is critical for you to mark VITA or TCE in the preparer's signature section of the return if you are not using the overprint forms.

After completing this lesson you should be able to:

- Calculate and report federal income tax withheld from all sources.
- Calculate and report estimated tax payments.
- Calculate the refund or amount due.
- Determine if estimated taxes should be paid.
- Determine if changes to the taxpayer's W-4 or W-4P should be suggested.

This lesson will provide detailed information on how to finish the tax return. The following checklist is provided as a quick reference of the steps needed to finish the return.

Checklist for Finishing the Return

- Add all Federal Income Tax Withholding from box 2 of Form W-2 and include on return.
- Add all Federal Income Tax Withholding from box 4 of Forms 1099R, 1099INT, 1099DIV and 1099G. Include in the payments section of the return.
- Include all estimated tax payments in the payment section.

POTENTIAL PITFALLS



Form W-2, box 4, shows social security tax withheld and box 6 shows Medicare tax withheld. These are not the same as federal income tax withheld. Do not report the amounts in box 4 and box 6 as federal income tax withheld.

POTENTIAL PITFALLS



When a taxpayer worked for more than one employer during the year, add up the amounts shown in box 4 of all Forms W-2. If the total in box 4 of all forms exceeds \$5,263.80 the taxpaver should claim a refund of excess social security tax withheld. Use the worksheet in Pub. 505, Tax Withholding and Estimated Tax to compute the refund.

- Include the amount of last year's refund that was applied to this year in the payment section. Note: If you need assistance with how to do this with TaxWise®, ask your site coordinator or computer specialist.
- Calculate all of the refundable credits (covered in later lessons) that the taxpayer is entitled to and include them in the payments section of the return. Using TaxWise® software will help you determine what credits that the taxpayer is entitled to.
- Add all payments together and enter them on the total payments line. TaxWise® will do this step for you.
- Subtract the total payments from the total tax. TaxWise® will also complete this step for you.
- Record the account number and the routing number for taxpayers who want their refund direct deposited. Note: TaxWise® will ask you for this information on the Main Information screen and on the tax form. This is to help ensure that you have keyed in the correct information. Complete the line to apply part of the refund to next year, if the taxpayer wishes to use this option.
- Explain the payment option (check, credit card, direct debit and installment agreement) to a taxpayer who owes money.
- Inform the taxpayer about the identifying information to include on payments made by check.
- Explain that interest and penalties continue to accrue on the unpaid balance even if the taxpayer has a valid installment agreement.
- Explain estimated taxes to taxpayers who expect to owe tax in 2003.
- Assist the taxpayer with completing form 1040ES for 2003. TaxWise® can do this for you. It will even print the vouchers for the payments.
- Provide the taxpayer with the mailing address for the estimated payments. (Some sites provide unstamped envelopes for the taxpayers.)
- Encourage taxpayers to consider adjusting their withholding (on Form W-4 or W-4P) if they have a large refund or owe more than \$1,000 on the return.
- Inform taxpayers about the Advanced Earned Income Credit, especially if they were eligible for EIC this year and have at least one qualifying child. Be prepared to give the taxpayer a Form W-5 if they request it.
- Complete the name and address section of the tax return. Use the taxpayer's label (if available) on a return prepared by hand. For computer generated returns, this section will be completed based on the information you entered in the Main Information section of the TaxWise® software.

- Make sure that you include the Taxpayer Identification
 Number for all taxpayers and dependents listed on the return.
 Note: If you are using TaxWise®, you will get an error when
 you run diagnostics if you have not included the identifying
 number. TaxWise® also has a diagnostic feature that helps you
 check the accuracy of the identifying number by comparing it
 to a database of information from the Social Security
 Administration. This does not guarantee that the name and
 social security number match. You should always try to look at
 the actual Social Security cards if possible.
- Mark the Presidential Election Campaign Box for the taxpayer. Note: If the taxpayer has a total tax of zero, the presidential campaign box should be marked no.
- Assemble the return. If filing a paper return for the taxpayer, forms should be in the order of the sequence number in the upper right corner. Procedures on assembling electronic returns may vary from site to site. Please ask your site coordinator for this information.
- Retain a copy of all electronic returns. Remember that you are not allowed to retain copies of the tax returns at your site past the end of the filing season. The retained copies should be forwarded to your local IRS territory office, where they will be retained until the end of the calendar year (as prescribed by the electronic filing regulations).
- Identify the return with the VITA or TCE designation in the preparer's signature section. Note: If you are using TaxWise®, you can set your initial forms so that this information is automatically included on every return you prepare.
- Submit the completed return to the quality reviewer at your site. Note: Not all sites have enough volunteers to have a designated quality reviewer. In this case, ask another volunteer to review the form you prepared. Using TaxWise® is not a substitute for quality review.
- Mark the area where the taxpayer should sign the return and/or Form 8453. Publication 3189 will contain additional information on how to use the PIN program to sign electronic returns.
- Complete the third party designation section of the return if the taxpayer wishes to allow someone else to discuss the return with the IRS. (You can't designate yourself.)
- Ask the taxpayer if they have any additional questions.
- Tell the taxpayer where to mail the return (if filing by paper). Some sites provide unstamped pre-addressed envelopes for their taxpayers. (You might be able to get the envelopes donated from a local office supply store. Your site receptionist could address the envelopes or you could print computer labels to use on them.)
- Keep track of the number of people you assist, using the method prescribed by your site coordinator.

PAYMENTS

The federal government has a pay-as-you-earn tax system. The information for the payments section of the return has three sources: federal income tax withholdings, estimated tax payments, and refundable credits.

Income tax withheld can appear on:

- Form W-2, Wage and Tax Statement, in box 2
- Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., in box 4
- Form 1099-INT, *Interest Income*, in box 4
- Form 1099-DIV, *Dividends and Distributions*, in box 4
- Form W-2G, Certain Gambling Winnings, in box 2
- Form 1099-G, Certain Government and Qualified State Tuition Program Payments, box 4
- SSA-1099 Social Security Benefits
- RRB-1099 Railroad Retirement Benefits Tier 1
- RRB-1099R Railroad Retirement Benefits Teir 2

Example 1

Susan has one Form W-2 (Exhibit 1).

The entry on line 7, Form 1040EZ, line 39, Form 1040A, or line 62, Form 1040, is \$988.

Exhibit 1

Susan's Form W-2

a Control number		MB No. 1545-0008		Safe, accurate, FAST! Use	7 ii	Visit the at www.	IRS Web Site .irs.gov.
b Employer identification number			1 W	/ages, tips, other compensation		2 Federal income	
10-0864213				12,350.00)	98	8.00
c Employer's name, address, and ZIP code XYZ Associates				ocial security wages		4 Social security	
				12,350.00)	765.70	
			5 Medicare wages and tips			6 Medicare tax v	
2112 Third Str				12,350.00			
Tampa, FL 336	521		7 8	ocial security tips		8 Allocated tips	
d Employee's social security number 000-00-2134			9 A	Advance EIC payment 10 Dependent care be			re benefits
e Employee's first name and initial L	ast name		11 N	lonqualified plans		12a See instruction	ns for box 12
Susan A. Howa	hrd					o d e	
134 Dawes Bly	.q		13 Statu	utory Retirement Third-part loyee plan sick pay	У	12b	
			L			e	
Tampa, FL 336	1%0		14 0	other		12c	
						12d	
						12d c a	
F Employee's address and ZIP code							
5 State Employer's state ID number	16 State wages, tips, etc.	17 State income ta	×	18 Local wages, tips, etc.	19	Local income tax	20 Locality nam
Wage and Tax Statement		2002)	Depar	tment c	of the Treasury-Intern	al Revenue Servi
opy B To Be Filed with Employee's I	FDFRAL Tax Return	(Rev. February 200)	•				
nis information is being furnished to the		(116V. 1 ebidaly 200	-,				

Example 2

Albert has a Form 1099-INT (Exhibit 2), a Form 1099-R (Exhibit 3), and a Form 1099-DIV (Exhibit 4). His total income tax withheld is entered on line 39, Form 1040A. It is \$1,247.

☐ cor	RECTED (if checked)			
PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional)	OMB No. 1545-0112		
Second Federal Bank 210 Miller Avenue		2002	Inte	rest Income
Denver, CO 86011		Form 1099-INT		
'AYER'S Federal identification number RECIPIENT'S identification numb	er 1 Interest income not include	d in box 3		Сору В
10-4213597 000-00-4213	\$ 935.00			For Recipient
RECIPIENT'S name	2 Early withdrawal penalty	3 Interest on U.S. Savi Bonds and Treas. ob		This is important tax
Albert B. George	\$	\$	information al being furnished to Internal Rev	
Street address (including apt. no.)	4 Federal income tax withheld			Service. If you are required to file a return.
1360 Shannon Avenue	\$ 187.00	\$ a negligence pena		
City, state, and ZIP code	6 Foreign tax paid	7 Foreign country or	U.S.	other sanction may be
Denver, CO 86011		possession		imposed on you if this income is taxable and
ccount number (optional)				the IRS determines that
	\$			it has not beer reported
rm 1099-INT (kee	o for your records)	Department of the T	reasury -	Internal Revenue Service

Exhibit 3 Albert's Form 1099-R

				d)	ED (if checke	CTE			
istributions Fro	_	IB No. 1545-0119	ОМ	ion	Gross distribut	1	PAYER'S name, street address, city, state, and ZIP code		
nsions, Annuitie Retirement of Profit-Sharin Plans, IRA Insurand Contracts, et	Pe	20 02 Form 1099-R		\$ 12,000.00 2a Taxable amount \$			APEX Triangles 213 Hickory Meadows		
Copy Report th	n 🔲	Total distribution			Taxable amour	2b		Denver, CO 86011	
income on you Federal ta return. If th	tax	Federal income withheld	4	cluded	Capital gain (in in box 2a)	3	RECIPIENT'S identification number	PAYER'S Federal identification number	
form show Federal incom		960.00	\$			\$	000-00-4213	10-9753124	
tax withheld box 4, attac this copy	urities	Net unrealized appreciation in employer's sec	6		Employee contr or insurance pre	5	RECIPIENT'S name Albert B. George		
your retur			\$			\$		· ·	
This information being furnished the Intern	%	Other	8 \$	IRA/ SEP/ SIMPLE	Distribution code	7	•	Street address (including apt. n 1360 Shannon Av	
Revenue Servic	ributions	Total employee con	9b \$	of total %	Your percentage distribution	9a	City, state, and ZIP code Denver, CO 86011		
12 State distribution	tate no.	State/Payer's s	11	eld	State tax withhe	10	Account number (optional)		
\$						\$			
15 Local distributi \$	У	Name of localit	14	eld	Local tax withhou	13 \$			
 \$						\$			

Exhibit 4 Albert's Form 1099-DIV

	OMB No. 1545-0110	TED (if checked) 1 Ordinary dividends		PAYER'S name, street address, city,	
District and a second		\$ 500.00	1	Denver Sheet Meta	
Dividends and Distributions	20 02	2a Total capital gain distr.	-	214 16th Street	
		2b 28% rate gain		Denver, CO 86013	
	Form 1099-DIV	\$			
Copy E	2d Unrecap. sec. 1250 gain	2c Qualified 5-year gain	RECIPIENT'S identification number	PAYER'S Federal identification number	
For Recipien	\$	\$	000-00-4213	10-2846731	
This is important tall information and is	3 Nontaxable distributions	2e Section 1202 gain		RECIPIENT'S name	
being furnished to the	\$	\$		Albert B. George	
Service. If you are required to file a return a negligence penalty o	5 Investment expenses \$	Federal income tax withheld 100.00	Street address (including apt. no.) 1360 Shannon Avenue		
income is taxable an	7 Foreign country or U.S. possession	6 Foreign tax paid \$	City, state, and ZIP code Denver, CO 86011		
the IRS determines that it has not bee	9 Noncash liquidation distr.	8 Cash liquidation distr.	Account number (optional)		
reported	 \$	\$			

COMMON QUERIES

Taxpayers use Form 1040-ES, *Estimated Tax for Individuals,* to make estimated tax payments.

TAX TIPS

***** If the taxpayer does not pay the amount shown on line 12 of Form 1040EZ, line 47 of Form 1040A, or line 73 of Form 1040. he or she will be charged interest and a late payment penalty even if a request to pay in installment payments is granted. To limit the interest and penalty charges, the taxpayer should pay as much of the tax as possible with the return.

Estimated Tax Payments

Add all estimated tax payments made by the taxpayer for the year. Be sure to include:

- Payment made from last year's overpayment (see last year's tax return.)
- Quarterly payments made using the Form 1040ES, including the one made in January of the current tax year.

Record total estimated tax payments on Line 40 of Form 1040A or Line 63 of Form 1040.

Refundable Credits

Make sure that any refundable credits you have calculated are entered on the proper lines. The Earned Income Credit is reported on line 8 of the Form 1040 EZ, Line 41 of the Form 1040A, and Line 64 of the Form 1040. Any refundable Child Tax Credit is reported on Line 42 of the Form 1040A and Line 66 of the Form 1040. If excess Social Security deductions were made because of multiple employers, that amount is shown on Line 65 of the Form 1040.

Total Payments

Add the total of withholdings, estimated tax payments made, and refundable credits together. Enter this total on Line 9 of the Form 1040EZ, Line 43 of the Form 1040A, or Line 69 of the Form 1040.

FIGURING THE OVERPAYMENT OR THE TAX DUE

Overpayments

If there has been more tax payments made than the amount of tax liability (Line 10, Form 1040EZ, Line 38, Form 1040A, or Line 61, Form 1040), this is considered an overpayment. A tax-payer may wish to have a portion of the overpayment applied to next year's taxes. If so, then enter the amount to be applied to the following year on Line 46 of the Form 1040A or Line 72 of the Form 1040. Subtract this amount from the total overpayment and enter the remainder on Line 45a of the Form 1040A or Line 71a of the Form 1040.

Only a total refund can be entered on the Form 1040EZ, Line 12a. Any overpayment on Form 1040EZ must be refunded; it cannot be applied to next year's taxes.

Example 3

Exhibit 5 shows Form 1040A, lines 28 through 46, for Ron. His total tax is \$3,491. His total payments are \$5,000. Ron overpaid and wants \$900 to be applied to his 2003 estimated tax. Note that line 45a plus line 46 equals the amount on line 44.

Exhibit 5 Ron's 1040A, page 2 dependent 3,491 00 Tax, including any alternative minimum tax (see page 33) 28 see page 33. 29 Credit for child and dependent care expenses. All others: Attach Schedule 2. Single, \$4,700 Credit for the elderly or the disabled. Attach Head of Schedule 3. 30 household, \$6,900 Education credits. Attach Form 8863 31 Married filing 32 Retirement savings contributions credit. Attach jointly or Qualifying Form 8880. 32 widow(er), 33 Child tax credit (see page 36). 33 \$7.850 34 Adoption credit. Attach Form 8839. Married Add lines 29 through 34. These are your total credits. filing separately, \$3,925 36 Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-. 36 3,491 00 37 Advance earned income credit payments from Form(s) W-2. Add lines 36 and 37. This is your total tax. ▶ 38 38 3,491 00 39 Federal income tax withheld from Forms W-2 2,600 and 1099. 39 00 2002 estimated tax payments and amount If you have applied from 2001 return. 2,400 00 40 a qualifying child, attach Earned income credit (EIC). 41 Additional child tax credit. Attach Form 8812. Schedule 42 42 EIC. Add lines 39 through 42. These are your total payments. 5,000 | 00 43 If line 43 is more than line 38, subtract line 38 from line 43. Refund This is the amount you overpaid. 44 1,509 00 Direct 45a Amount of line 44 you want refunded to you. ▶ 45a 609 00 deposit? Routing See page 47 ▶ c Type: ☐ Checking ☐ Savings number and fill in 45b, 45c, ▶ d Account and 45d. number Amount of line 44 you want applied to your 00 2003 estimated tax. 900 46

TAX TIPS

If the taxpayer owes
an estimated tax
penalty (line 48,
Form 1040A and line
74, Form 1040) the
penalty should be
added to the tax due
on line 47 of the 1040A
or line 73 of 1040.

Refunds

If the taxpayer wants any overpayment refunded, advise that a check should be mailed within 6-8 weeks after the return is filed. Remind the taxpayer of the availability to have the refund deposited directly into a financial account, such as a bank account.

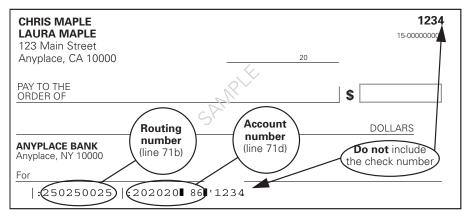
Direct Deposit

Instead of getting a paper check, taxpayers may choose to have their refund deposited directly into their account at a bank or other financial institution such as a mutual fund, brokerage firm, or credit union.

Note. Taxpayers should check with their financial institution to make sure their direct deposit will be accepted and to get the correct routing and account number.

Exhibit 6 shows the general location of the routing and account number on a sample check. The routing number must be nine digits (the first two digits must begin with 01 through 12 or 21 through 32, otherwise the direct deposit will be rejected and a check sent instead). The account number can be up to 17 characters (both numbers and letters). It can include hyphens but not spaces or special symbols. The number should be entered from left to right with any unused boxes left blank.

Exhibit 6



Exercise 1

A. Helen paid \$500 in estimated tax to the United States Treasury. Where is this reported on Form 1040A?

B. Shirley paid \$200, the amount owed on last year's income tax return. Is the \$200 an estimated tax payment for this year's income tax return?

C. Elmer wants his refund deposited in his checking account. What information should you enter on line 45b of his 1040A form?_____

D. Jennifer had tax withheld from her wages on Form W-2. She also had some withholding on her Form 1099-R. Can these items be combined and listed on one line on her tax return?

TAX TIPS

***** If the taxpayer does not pay the amount owed that is shown on his or her return, the taxpayer will still be charged interest and a late payment penalty even if his/her request to pay in installment payments is granted. To limit the interest and penalty charges, the taxpayer should pay as much of the tax as possible with his/her return.

TAX TIPS

Before requesting
an installment
agreement, the taxpayer should consider less costly
alternatives, such
as a bank loan.

ALERT

***** To pay by credit card. the taxpayer must call one of the service providers listed in the forms instructions and follow the instructions. A convenience fee will be charged by the service provider based on the amount paid by the taxpayer. Do not include the convenience fee as part of the tax payment. The taxpayer must enter the confirmation number given at the end of the call on Page 1 of his or her tax form in the upper left corner.

Tax Due

If there are less tax payments than the amount of tax liability, then there is tax due to be paid with the return. When this happens, remind the taxpayer to make the check or money order payable to the "United States Treasury." Taxpayers can also pay by credit card or by authorizing a direct debit from their checking or savings account on the date they choose (anytime up to April 15, 2003). Encourage a 1040 filer to voluntarily send Form 1040-V, *Payment Voucher*, with his or her payment. The instructions for completing the voucher appear on the 1040-V. The taxpayer should write his or her name, address, social security number, daytime telephone number, and "2002 Form 1040 (or 1040A or 1040EZ, whichever applies)" on the check or money order. The payment and Form 1040-V should be enclosed, but not attached to the tax return. Taxpayers should not mail cash with their returns.

To help IRS process the payment, the taxpayer should enter the amount on the right side of the check like this: \$XXX.XX. Do not use dashes or lines (for example, do not enter "\$XXX—" or "\$XXX^{XX}/100").

Electronic Payment Options

If the taxpayer owes an amount on his or her return, he/she can make the payment electronically. To pay by credit card, the taxpayer must use one of the service providers listed in the instructions for Forms 1040, 1040A, or 1040EZ. The taxpayer can also pay by authorizing a direct debit out of his/her checking or savings account by April 15, 2003.

If the taxpayer cannot pay the full amount owed shown on his/her return, the taxpayer may ask permission to make monthly installment payments. To ask for an installment agreement, the taxpayer should file Form 9465, *Installment Agreement Request*, with the tax return.

Estimated Tax Penalty. If line 10, Form 1040EZ, line 47, Form 1040A, or line 73, Form 1040, is \$1,000 or more and it is more than 10 percent of the tax shown on the return, or if the taxpayer underpaid his or her 2002 estimated tax liability, the taxpayer can owe a penalty for underpayment of estimated tax. If so, report the penalty on line 48 for Form 1040A or line 74 of Form 1040. Line 47 or line 73 should include the amount owed with the return plus the penalty reported on line 48 of Form 1040A or line 74 of Form 1040, respectively.

Because the Form 2210, *Underpayment of Estimated Tax by Individuals*, *Estates, and Trusts*, used to compute estimated tax penalty is complicated, the IRS encourages taxpayers to let the IRS figure the penalty for them. The IRS will figure the penalty for underpayment of estimated tax and, if a penalty is owed, the taxpayer will be sent a bill. If taxpayers want the IRS to figure the penalty for them, the taxpayers should leave the penalty line on their return blank and **should not** complete Form 2210. As long as the taxpayer files the return by April 15, 2003, the IRS will not charge interest on the penalty if the bill is paid by the date specified on the bill.

PERSON PERSON

Remember to respect the taxpayer's privacy. Keep the taxpayer's personal and tax information confidential.

FIGURING ESTIMATED TAX FOR NEXT YEAR

Estimated tax is the amount a taxpayer expects to owe for the year, after deducting any tax credits or federal income tax withheld. In other words, it is the amount the taxpayer anticipates will be owed on his or her 2003 federal income tax return.

If a taxpayer is an employee, the taxpayer's employer generally must withhold income, Medicare, and social security taxes on the wages paid. Also, most payers of taxable pensions withhold income tax and pay it to the government. However, a taxpayer may receive many types of taxable income that are not subject to having tax withheld.

A taxpayer who receives interest, dividends, alimony, unemployment compensation, rent, gains from the sale of assets, prizes, or awards, generally will have no income tax withheld on the payments. As a result, the taxpayer may find that he or she owes estimated tax. Most self-employed taxpayers will also find they are required to pay estimated tax.

Who Must Pay Estimated Tax

Estimated tax payments are required if certain conditions are met. Generally a taxpayer must make payments of estimated tax if:

1. He or she expects to owe \$1,000 or more in tax for 2003 after subtracting federal income tax withheld and credits from taxable income,

AND

- **2.** He or she expects the 2003 tax withheld and credits to be less than the smaller of:
 - **a)** 90 percent of the tax to be shown on his or her 2003 tax return, or
 - **b)** 100 percent of the tax shown on his or her 2002 tax return. The return must cover all 12 months.

TAX TIPS

A taxpayer does not have to pay estimated tax if the 2002 return showed zero total tax or if no return was required.

POTENTIAL PITFALLS



When figuring estimated tax, be sure to include all taxes, such as tax on lumpsum distributions and self-employment tax.

PERSON PERSON

Some taxpayers who begin making estimated tax payments late in the year may believe that they are entitled to divide the tax by the number of payment periods remaining and pay in equal installments. The payments are always figured on the basis of one fourth of the year's total. The later the taxpayer begins paying, the greater the number of payments that must be added together and paid as the first payment in order to bring the taxpayer up to date on the payment schedule.

COMMON QUERIES

Checks for payment of taxes or estimated taxes need to be made payable to the "United States Treasury".

Married taxpayers can pay estimated tax either separately or jointly. How they pay their estimated tax will not affect their choice of filing a joint return or separate returns for the year. Joint estimated tax payments may be divided between the spouses if they later choose to file separate returns.

Example 4

Alma is single and retired. She works part time as an usher in a movie theater. She estimates her 2003 income will be \$16,421, which includes \$3,500 of interest income from which there will be no tax withheld. Alma calculates that she expects to owe \$1,008 (after taking into account her expected tax withheld and credits). Alma meets condition 1 (mentioned earlier) and may have to pay estimated tax. Further checking tells Alma that her expected 2003 tax withheld will be less than 100 percent of the tax shown on her 2002 return and less than 90 percent of the tax she will show on her 2003 tax return. Since Alma also meets condition 2 (mentioned earlier), she is required to pay estimated tax.

Limit on the use of prior year's tax. Married taxpayers with joint AGI exceeding \$150,000 or \$75,000 if married filing separately cannot use 100% of their 2002 tax to figure their 2003 estimated tax payments.

For more information, see Publication 505, *Tax Withholding and Estimated Tax*.

How to Figure Estimated Tax

Estimated tax is paid by using Form 1040-ES, *Estimated Tax For Individuals*. Form 1040-ES also contains a worksheet that can be used in figuring a taxpayer's estimated tax. The taxpayer should keep the worksheet for his or her records.

To figure the estimated tax, the taxpayer must first figure his or her expected adjusted gross income, taxable income, taxes, and credits for 2003. All available facts that will affect those items during the year must be taken into account. Use the 2002 tax return as a starting point for estimating 2003 income, deductions, and credits. However, be careful to make adjustments both for anticipated changes in the taxpayer's situation and for recent changes in the tax law.

Form 1040-ES contains both the 2003 Tax Rate Schedules and the 2003 standard deduction and exemption amounts. Be sure to use the 2003 figures when figuring the estimated tax.

When to Pay Estimated Tax

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific due date.

Date taxpayer receives income	Due date of first installment	No. of payments
January 1 – March 31	April 15, 2003	4
April 1 – May 31	June 16, 2003	3
June 1 – August 31	September 15, 2003	2
September 1 – December 31	January 15, 2004	1
T and the second		

Most of the taxpayers that you assist will pay their estimated tax in four equal installments. However, a taxpayer does not have to make estimated tax payments until he or she has income on which tax is owed. If a taxpayer receives income after one or more of the payment periods have passed, he or she will begin making payments during the period when the income is received.

The minimum payment due during the period when the income is received is one-fourth of the total estimated tax for the year, generally, plus an additional fourth of the yearly total for each period which has already passed. The balance of the estimated tax will be paid during the remaining periods (one-fourth of the yearly total for each remaining period).

The taxpayer also has the option of paying all the estimated tax at once. Instead of paying by installments, he or she may choose to pay the entire amount by the due date of the period during which the income is received.

Some taxpayers choose to pay all of their estimated tax with the first payment, April 15, 2003. It alleviates the need for them to remember to make the remaining payments.

Also, a taxpayer can apply all or part of an overpayment from his or her 2002 Form 1040 or Form 1040A to the estimated tax for 2003. The overpayment amount to be credited is entered on Form 1040, line 72, or Form 1040A, line 46. All of the credit can be applied to the first payment or it can be spread out among any or all of the payments.

If any due date falls on a Saturday, Sunday, or legal holiday, the payment is due on the next business day.

If a taxpayer files his or her 2003 Form 1040 or Form 1040A by January 31, 2004, and pays the entire amount of tax owed at that time, he or she is not required to make the estimated tax payment that would be due on January 15, 2004.

TAX TIPS

Remember, estimated tax equals the amount the taxpayer expects to owe after credits and after tax is withheld.

POTENTIAL PITFALLS



Advise the taxpayer to use the preaddressed envelopes that came with his or her Form 1040-ES package, or mail payment vouchers to the address shown in the Form 1040-ES instructions for the place where he or she lives. Do not use the address shown in the Form 1040 or Form 1040A instructions.

SPECIAL POPULATIONS

Farmers and fishermen can follow different rules for their estimated taxes.

TAX TIPS ******** A taxpayer will not have to pay estimated tax if enough is paid through tax withholding to keep the 2003 amount owed under \$1000.

PERSON PERSON

A taxpayer may become upset when you mention a penalty, especially if he or she made estimated tax payments. Stress that an estimate is inexact and that a change, for example, in income during the year can affect the original estimate.

How Much Estimated Tax to Pay

The computed estimated tax is based on expected income and deductions and should take into account all facts known at the time the estimate is made. If the taxpayer is unsure about the accuracy of the estimate, he or she may want to pay more than the required minimum 90 percent of the 2002 estimated tax. Taxpayers who do not pay enough tax by the due date of each payment period may be charged a penalty, even if the filed 2003 return shows a refund. Generally, the simplest and safest procedure is to make sure that the total of tax withheld plus the amount of estimated tax for each payment period during 2003 is at least one-fourth of the tax shown on the 2002 return. For more information, see Publication 505.

How to Pay Estimated Tax

Estimated tax payments can be sent electronically to the IRS by direct debit payment from the taxpayer's checking or savings account, by credit card, or can be sent along with a payment voucher from Form 1040-ES. Each voucher is inscribed with its due date. Be sure to use the correct voucher for each payment. For more information on electronic filing and payments, see the Form 1040-ES instructions.

If the taxpayer paid estimated tax in 2002, he or she should have received a Form 1040-ES package containing pre-printed vouchers. These vouchers show the taxpayer's pre-printed name, address, and social security number. To use them, simply enter the amount of the payment on the appropriate line. If a taxpayer does not have the preprinted forms, use a set of blank vouchers from Form 1040-ES and enter the information on the appropriate lines. Advise the taxpayer to write his or her social security number and "2003 Form 1040-ES" on the check or money order (payable to the "United States Treasury") when paying estimated tax.

FORM W-4 AND W-4P

An employer withholds tax based on wages paid and information the employee provides on Form W-4, *Employee's Withholding Allowance Certificate*. The employee uses his or her expected income, deductions, adjustments to income, and credits to figure the total withholding allowances to claim on Form W-4. In addition, an employee can claim extra allowances in certain situations.

A taxpayer who receives distributions from a pension, an annuity, an IRA, a stock bonus plan, or certain deferred compensation plans should use Form W-4P, *Withholding Certificate for Pension or Annuity Payments*, to notify the payer whether, and how much, income tax should be withheld.

Income, deductions, and credits should be estimated carefully. Taxpayers who do not have enough federal income tax withheld can be subject to interest and penalties. Taxpayers who have a very large refund or who owe should consider adjusting their withholding.

Some taxpayers want their withholding to be high enough to ensure that they receive a tax refund. They do not want to pay an additional amount when filing their tax return. If a taxpayer wishes, it is legal to claim fewer allowances than he or she is allowed. More tax than required will be withheld each pay period and, at the end of the year, the taxpayer should be eligible for a refund of overpaid taxes.

The Forms W-4 and W-4P also contain:

- Instructions
- Personal Allowances Worksheet
- Deductions and Adjustments Worksheet
- Two-Earner/Two-Job, Multiple Pension/More Than One Income Worksheets
- Tables

COMMON QUERIES

An employee can claim exemption from withholding only if all 2002 withholding was refunded because no tax was owed and no tax liability is expected in 2003.

TAX TIPS

Complete separate
Form W-4 worksheets only if the
taxpayer and his or
her spouse will file
separate returns.

The worksheets incorporate the number of allowances, adjustments, deductions, and credits that the employee expects on his or her 2003 income tax return. Some or all of these additional worksheets will then be used by the employee in completing the allowance certificate.

If an employee has a working spouse or income from two jobs, only one set of Form W-4 worksheets should be completed. Complete the Form W-4 worksheets using the combined expected income, adjustments, deductions, and exemptions. The number of total allowances from this Form W-4 can then be divided among all jobs. Withholding will usually be the most accurate when an employee claims zero allowances on all jobs except for the highest paying one.

Certain events can occur during the year that can change an employee's marital status, exemptions, allowances, deductions or credits. When this happens, the employee may have to change his or her withholding allowances by submitting a new Form W-4 to the employer. The original Form W-4 remains in effect until the employee changes it.

For more information on withholding, refer to Publication 919, How Do I Adjust My Tax Withholding?

W-5, Advance Earned Income Credit (AEIC)

At this time, you the preparer have the opportunity and the means to assist the taxpaver with the Form W-5, Earned Income Credit Advance Payment Certificate. The amount of the AEIC payments are based on wages by payroll cycle. Only persons with at least one qualifying child can get AEIC payments. If the taxpayer qualifies for the Earned Income Credit for 2002 refer them to Publication 596, Earned Income Credit or Form W-5 for additional information.

Completing and Assembling the Return

After all the decisions have been made regarding payments, overpayments, and estimated taxes, you should complete the taxpayer identification section, assemble the return, and submit it for quality review. When the review is completed, have the taxpayer sign the return and provide instructions on where and when to send it to the IRS. These steps are provided below.

Taxpayer Identification Section

This section is completed after the rest of the return. Often, this saves time because after you begin preparing Form 1040A, you may discover that Form 1040EZ or Form 1040 is more appropriate. If this happens, you will not have to complete the taxpayer identification section twice.

Taxpayers who filed returns last year probably received a forms package by mail this year. The package includes a preaddressed label which shows the name and address of the taxpayer(s).

Peel the label off and place it in the address area of the return. Mark through any errors on the label, and print the correct information on the label. Be sure to enter the social security number(s) (or Taxpayer Identification Number (ITIN) to the right of the label area.

If a taxpayer did not receive a forms package or does not have a pre-addressed label, PRINT the required information. Enter the taxpayer's name and social security number (or ITIN) on the first line. If married taxpayers are filing a joint return, enter one spouse's complete name and social security number (or ITIN) on the first line and the other spouse's complete name and social security number (or ITIN) on the second line. Be sure that each taxpayer's name and social security number (or ITIN) appear on one line, separate from the spouse's information. If you enter the husband's name and the wife's social security number (or ITIN) on the same line, there can be a considerable delay in processing the return.

Enter the address where any refund or notices should be sent. If the post office delivers mail to a post office box rather than to a street address, enter the P.O. box number on the line for the home address.

The Presidential Election Campaign Fund appears in the name and address area of Forms 1040EZ, 1040A, or 1040. Check Yes if the taxpayer wishes to have \$3 go to the Presidential Election Campaign Fund. Otherwise, check No. Checking Yes will not change the tax or reduce the refund. On a joint return, each taxpayer chooses whether or not \$3 should go to the fund.

POTENTIAL PITFALLS



Using the pre-addressed label reduces processing time. However, to protect the taxpayer's privacy, the peel-off label that he or she received in the mail with the tax return booklet does not have his or her SSN (or that of his or her spouse if filing a joint return) printed on it. Therefore, be sure the taxpayer's SSN (and spouse's, if applicable) is entered in the space provided on the tax form (1040, 1040A, or 1040EZ).

Further, if the taxpayer filed a joint return for 2001 and is filing a joint return for 2002 with the same spouse, *be sure* the taxpayer's and spouse's names and SSN's are entered in the same order as on the 2001 tax return.

TAX TIPS

Name change. Taxpayers who have changed their names because of marriage, divorce, etc., should be sure to report this to the Social Security Administration. This prevents delays in processing returns and issuing refunds and safeguards future social security benefits.

Assembling the Return

Make sure that all forms, schedules, and attachments show the taxpayer's name and social security number. List the names in the same order that they appear on the front of the return and use the first social security (or ITIN) number that appears on the front of the return.

Attach forms and schedules behind Form 1040 according to the attachment sequence number shown in the upper right corner of the form or schedule. Items without an attachment sequence number should be placed at the end. For Form 1040A, attach any forms or schedules in order by number with Schedule EIC last.

Attach Form(s) W-2 to the left margin of the return. If any Form 1099 shows federal income tax withheld, include that amount in the payments section of the return.

When any Form 1099 shows federal income tax withheld, attach a copy to the return, along with any Form(s) W-2.

IDENTIFYING RETURNS

Tax returns prepared by or with the assistance of TCE and VITA volunteers are identified on the tax form. This identification helps the IRS count the number of returns prepared by volunteers nationwide.

If taxpayers ask about the "TCE" or "VITA" designation at the bottom of the return, explain that this is done for statistical purposes. Inform the taxpayers that the designation does not affect the likelihood of an IRS examination (audit) of the return.

If you prepare over 50 percent of the tax return and you are reasonably sure that the return will be filed as you prepared it, enter the "VITA" or "TCE" designation at the bottom of the return. If the assistance you provide is limited to answering taxpayer questions, you do not need to enter the volunteer designation on the tax return. Do not enter volunteer designations on schedules and attachments.

Most sites will have forms preprinted with volunteer designations. For Form 1040A and Form 1040, the designation appears under the signature block on page two. For Form 1040EZ, the designation appears at the bottom of page one. Volunteers should circle the appropriate designation, "VITA" or "TCE."

If you do not have forms with the preprinted designation, print the appropriate designation in bold letters in the "Paid preparer's use only" block at the bottom of page two. On Form 1040A and 1040 and on the bottom of page one of Form 1040EZ.

Enter your site number on the line directly to the right of the "VITA/TCE" designation.

QUALITY SERVICE

The goal of the TCE and VITA Programs is to provide high quality service.

On-Site Quality Review Program

Every site should have a quality review program. Properly reviewed returns will help prevent taxpayers from receiving an error notice from the IRS. At larger sites, an experienced volunteer should be designated as the quality reviewer. At small sites, volunteers may review each other's work. A Quality Review Checklist, like the one shown below, may be used for this purpose.

OVERPRINT **I**NSTRUCTIONS

Effective October 1, 2002, VITA/TCE volunteers no longer have the responsibility of reporting statistics using Form 6522. The Internal Revenue Service (IRS) will capture this information using the Individual Master File Report (IMF Report) and the Electronic Tax Administration (ETA) report. Based on this change, it is very important that **all returns** prepared by a volunteer tax preparation site be identified as VITA or TCE prepared. "VITA or TCE" should be marked, written or stamped on the form in the space provided for "Paid Preparer's Use Only" (see Exhibit)

The following procedures <u>must</u> be used when returns are prepared in a VITA or TCE site.

- 1. Paper Returns
- TCE Sites will circle TCE and VITA will circle VITA
- If you use a return without the overprint, you must mark VITA or TCE whichever applies in big bold letters in the "Paid Preparer's Use Only".
- 2. Electronically filed returns
- E~file administrators will set up computers to indicate VITA or TCE acronyms in the "non-paid preparer indicator" section
- If the return rejects or does not qualify for electronic filing the return must be marked VITA or TCE in the "Paid Preparer's Use Only" section.

COMMON QUERIES

If the taxpayer moves, he or she should notify the IRS using Form 8822, Change of Address. The taxpayer should mail it to the same IRS service center where the last return was filed.

TAX TIPS

A resident or nonresident alien who
does not have, or
cannot get an SSN,
should file a Form
W-7 with the IRS to
apply for an individual taxpayer identification number (ITIN).

The ITIN is entered on the return wherever the SSN is requested, and is used for tax purposes only.

TAX TIPS

Make sure the social security number is entered correctly in the designated area of the tax return. An incorrect number could delay the taxpayer's refund.

COMMON QUERIES

The IRS quality review does not make an examination (audit) more likely nor does it otherwise affect the taxpayer's return.

- Are the name, address, and **social security number** correct for each taxpayer on the return?
- Is the social security number(s) or ITIN(s) entered to the right of the label area?
- Is the Presidential Election Campaign Fund box(es) checked?
- Is the filing status correct? Is the box checked?
- Are the exemptions and dependents checked, listed, and added correctly?
- Are dependents' social security numbers or ITINs entered?
- Are income items correctly transferred from Form W-2, Form 1099-INT, Form 1099-DIV, Form 1099-G, Form 1099-R, and Form SSA-1099 (or RRB-1099), for example?
- Is tax-exempt interest income reported? Is "TEI" written to the left of line 2 on Form 1040EZ?
- Is the taxable portion of social security benefits, IRA distributions, pensions, and/or annuity income correctly figured?
- Are there IRA withdrawals to report?
- Is there any other income to report (lottery, fees, etc.)?
- If the taxpayer paid alimony, is the recipient's social security number entered?
- Are all appropriate boxes on line 37a, Form 1040 or line 23a, Form 1040A or line 5, Form 1040EZ checked?
- Is the standard deduction correct? Complete worksheet if taxpayer is someone else's dependent.
- Is the tax correct?
- Is the taxpayer eligible to claim the credit for child and dependent care expenses, child tax credit, education credits, adoption credit, or credit for the elderly or the disabled?
- Does the tax withheld agree with the total of amounts shown on all Forms W-2, 1099-INT, 1099-DIV, and 1099-R?
- Are the estimated tax payments correct?
- Is the taxpayer eligible to claim the earned income credit?
- Is the overpayment or the amount owed correct? Does the taxpayer want any part of the refund applied to next year's estimated tax? Does the taxpayer want the refund or any part directly deposited?
- Did you use a calculator to check your math?
- Are all Forms W-2 and 1099 (showing tax withheld), as well as schedules and forms, attached to the return?
- Is the appropriate volunteer site designation entered?
- Did the taxpayer(s) sign, date, and fill in his/her occupation on the return?
- Is the taxpayer eligible to claim the Earned income credit? Advanced earned income credit?

Signature section

Make sure the taxpayer signs and dates the return before mailing. An unsigned return cannot be processed and may be sent back to the taxpayer. On a joint return, both spouses must sign, even if only one spouse had income. Also, make sure the occupation(s) of the taxpayer (or of both spouses, if married filing jointly) is entered.

If a taxpayer died before filing a return for 2002, the taxpayer's spouse or personal representative may have to file and sign a return for that taxpayer. A personal representative can be an executor, administrator, or anyone who is in charge of the deceased taxpayer's property. If the deceased taxpayer did not have to file a return but had tax withheld, a return must be filed to get a refund. The person who files the return should enter "DECEASED," the deceased taxpayer's name, and the date of death across the top of the return.

If the taxpayer's spouse died in 2002 and the taxpayer did not remarry in 2002, the taxpayer can file a joint return. (The taxpayer can also file a joint return if his or her spouse dies in 2003 before filing a 2002 return.) A joint return should show the taxpayer's spouse's 2002 income before death and the taxpayer's income for all of 2002. The taxpayer should enter "Filing as surviving spouse" in the area where the taxpayer signs the return. If someone else is the personal representative, he or she must also sign.

The surviving spouse or personal representative should promptly notify all payers of income, including financial institutions, of the taxpayer's death. This will ensure the proper reporting of income earned by the taxpayer's estate or heirs. A deceased taxpayer's social security number should not be used for tax years after the year of death, except for estate tax return purposes.

Third-Party Designee

If the taxpayer wants to allow a friend, family member, or any other person he or she chooses to discuss his or her 2002 tax return with the IRS, the taxpayer should check the "Yes" box in the "Third party designee" area of the return. Also, the taxpayer should enter the designee's name, phone number, and any five numbers the designee chooses as his or her personal identification number (PIN).

If the taxpayer checks the "Yes" box, he or she, and his or her spouse if filing a joint return, is authorizing the IRS to call the designee to answer any questions that may arise during the processing of the return. The taxpayer is also authorizing the designee to:

■ Give the IRS any information that is missing from the return,

- Call the IRS for information about the processing of the return or the status of the taxpayer's refund or payment(s), and
- Respond to certain IRS notices that the taxpayer has shared with the designee about math errors, offsets, and return preparation. The notices will not be sent to the designee.

The taxpayer is not authorizing the designee to receive any refund check, bind the taxpayer to anything (including any additional tax liability), or otherwise represent the taxpayer before the IRS. If the taxpayer wants to expand the designee's authorization, he or she should see Publication 947, *Practice Before the IRS and Power of Attorney*.

The authorization cannot be revoked. However, the authorization will automatically end no later than the due date (without regard to extensions) for filing the taxpayer's 2003 tax return. This is April 15, 2004, for most people.

As a volunteer preparer you should not be designated as a "Third Party Designee."

Ending the Interview

Make sure the taxpayer keeps a copy of all Forms W-2 and 1099 with a copy of the tax return. Advise the taxpayer to keep these copies for at least three years. As the volunteer assistor, you should not keep a copy of the return.

If an envelope has been provided for the taxpayer's records place the copies into it. Advise the taxpayer to bring the envelope back next year.

VOLUNTEER ASSISTANCE WORKSHEET

The Volunteer Assistance Worksheet is currently under revision and was not available at publication date. Your local Stakeholder Partnerships, Education and Communication office will provide you with the revised Volunteer Assistance Worksheet when you attend training along with the training module that explains the new worksheet and reporting requirements.

Exercise 2

Look at the completed Form 1040EZ shown in Exhibit 7 and identify at least 3 areas that have not been properly completed.

Exhibit 7 Form 1040 EZ, page 1

Form 1040EZ	Income Tax Return for Single and Joint Filers With No Dependents (99)	002	OMB No. 1545-0675
Label (See page 12.) Use the IRS label.	If a joint return, spouse's first name and initial Last name	Apt. no.	Your social security number 123 45 6789 Spouse's social security number
Otherwise, please print or type.	1040 Main Street City, town or post office, state, and ZIP code. If you have a foreign address, see	A	▲ Important! ▲ You must enter your SSN(s) above.
Presidential Election Campaign (page 12)	Anywhere, USA 99999 Note. Checking "Yes" will not change your tax or reduce your Do you, or your spouse if a joint return, want \$3 to go to this		You Spouse Yes No Yes No
Income Attach	1 Total wages, salaries, and tips. This should be shown in bo form(s). Attach your W-2 form(s).	x 1 of your W-2	1 14,900 00
Form(s) W-2 here. Enclose, but do not attach, any payment.	 2 Taxable interest. If the total is over \$400, you cannot use For 3 Unemployment compensation and Alaska Permanent Fund (see page 14). 4 Add lines 1, 2, and 3. This is your adjusted gross income 	dividends	2 2 00
Note. You must check Yes or No.	5 Can your parents (or someone else) claim you on their return Yes. Enter amount from No. If single, enter worksheet on back. If married, enter See back for each of the state of the st	urn? r \$7,700. nter \$13,850. explanation.	5
	6 Subtract line 5 from line 4. If line 5 is larger than line 4, 6 This is your taxable income.	enter -0	6 14,900 00
Payments and tax	7 Federal income tax withheld from box 2 of your W-2 form8 Earned income credit (EIC).	(s).	7 1,700 00
	9 Add lines 7 and 8. These are your total payments.	•	9 1,700 00
	10 Tax. Use the amount on line 6 above to find your tax in the 24-28 of the booklet. Then, enter the tax from the table on		10 1,490 00
Refund Have it directly deposited! See page 20 and fill in 11b, 11c, and 11d.	11a If line 9 is larger than line 10, subtract line 10 from line 9 b Routing number		· 11a 2 00
Amount you owe	12 If line 10 is larger than line 9, subtract line 9 from line 10. the amount you owe. For details on how to pay, see page 2	_	· 12
Third party designee	Do you want to allow another person to discuss this return with to Designee's Phone no. ▶ (Personal ide) number (PIN	V) •
Sign here Joint return? See page 11. Keep a copy for your records.	Under penalties of perjury, I declare that I have examined this return, and accurately lists all amounts and sources of income I received during the tax on all information of which the preparer has any knowledge. Your signature Date Spouse's signature. If a joint return, both must sign. Lucinda Mendez Date 1/23/03		
Paid preparer's use only	Preparer's signature Firm's name (or yours if self-employed), address, and ZIP code Privacy Act, and Panaryyork Reduction Act Notice see pa	Check if self-employed EIN Phone no.	

▶▶ SUMMING UP THIS LESSON ◀◀

The information for the payment section of the return comes from these sources:

- federal income tax withheld by the employer, and
- ► Forms 1099, and
- estimated tax payments paid by the taxpayer (not reported on Form 1040EZ), and
- refundable credits.

If the amount owed is \$1,000 or more, the taxpayer may have to pay an estimated tax penalty. If there is an overpayment, the taxpayer can take one of the following courses of action:

- receive a complete refund,
- ▶ apply the overpayment to the next year's estimated tax, or
- receive a partial refund and apply the remainder of the overpayment to the next year's estimated tax.

Estimated tax payments must be made if a taxpayer:

► Expects to owe \$1,000 or more in tax for 2003 after subtracting income tax withheld and credits,

AND

Expects his or her 2003 tax withheld and credits to be less than the smaller of: 90 percent of the tax to be shown on his or her 2003 tax return or, generally, 100 percent of the tax shown on his or her 2002 tax return.

Withholding allowances for employees are reported on Form W-4. Allowances for pension or annuity recipients are reported on Form W-4P. They are figured by taking into account:

- Expected income
- **▶** Deductions
- ► Credits
- ► Adjustments to income

To finish the return:

- Consider the taxpayer's possible eligibility for Advance Earned Income Credit.
- ➤ Complete the taxpayer's identification section after you have finished the rest of the return.
- ► Enter the volunteer designation in the paid preparer's section.
- ➤ Assemble the return correctly, attaching any Forms W-2 and any Forms 1099 showing federal income tax withholding.
- ► Check each return for completeness and accuracy.
- ➤ Submit each return for on-site quality review.
- ► Have the taxpayer(s) sign and date the return.

FINISHING THE RETURN— FINAL STEPS Answers to Exercise

Lesson 7

Answers to Exercise 1

- (A) Line 40
- (B) No.
- (C) The routing number for his bank account, and type of account
- (D) Yes.

Answers to Exercise 2

- Wife's SSN is missing
- Presidential Election Campaign is not marked
- Husband's signature is missing
- VITA designation and site number is missing
- Line 4 is blank
- Line 5 is blank
- Line 6 is incorrect
- Line 11a is incorrect
- Occupations are missing

	STUDENT NOT	ES
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CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

Lesson 8

Introduction and Objectives

In this lesson you will learn about the credit for child and dependent care expenses. This nonrefundable credit is one of the most commonly used credits.

After completing this lesson you should be able to:

- Determine who is eligible for the child and dependent care credit.
- Calculate the credit and report on the correct form

CREDITS

A credit is a dollar-for-dollar reduction of the taxpayer's tax liability. A **refundable** credit can be greater than the tax. Taxpayers not only can have their tax reduced to zero; they can also receive a "refund" of excess credit. A **nonrefundable credit** can also be greater than the tax, but the nonrefundable credit can only reduce the tax to zero. Therefore, taxpayers will not receive a refund for any excess nonrefundable credit.

The Hope credit, the lifetime learning credit, the credit for child and dependent care expenses, the credit for the elderly or the disabled, the mortgage interest credit and the credit for qualified retirement savings contributions are nonrefundable credits.

The child tax credit is generally nonrefundable; but some taxpayers can qualify for the refundable additional child tax credit.

TAX TIPS

***** Some taxpayers can take a nonrefundable adoption tax credit for qualifying expenses paid to adopt an eligible child. Refer taxpayers with adoption expenses to a paid professional tax preparer. They can also get Publication 968, Tax Benefits for Adoption, for more information.

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

The credit for child and dependent care expenses is one of the most commonly used credits.

This credit can be claimed on either Form 1040A or Form 1040. The requirements for claiming the credit are the same, regardless of the form used. If the taxpayer files Form 1040A, the credit is figured on Schedule 2, *Child and Dependent Care Expenses for Form 1040A Filers*. If the taxpayer files Form 1040, the credit is figured on Form 2441, *Child and Dependent Care Expenses*. If the taxpayer claims the credit, attach Schedule 2 or Form 2441 to the tax return.

To qualify for the credit, a taxpayer must have:

- Incurred expenses for the care of a qualifying person,
- Incurred expenses in order to work or look for work,
- Earned income for work performed during the year (see first exception below),
- Filed a joint return if married (see second exception below),
- Maintained a home (paid over half the cost) that was also the home of a qualifying person,
- Paid the expenses to someone other than his or her child (under age 19) or a dependent claimed on the tax return,
- Identified the care provider on the tax return, and
- Excluded less than \$2,400 (\$4,800, if 2 or more qualifying persons) of dependent care assistance benefits.

There are two exceptions.

- **1.** A spouse who is a full-time student for some part of each of five months of the year or who is incapable of self-care is considered to have earned income.
- **2.** A married taxpayer does not have to file a joint return to receive the credit if legally separated or living apart from his or her spouse. A taxpayer is not considered married and is eligible to take the credit if *all* of the following apply.
 - The taxpayer files a separate return.
 - The taxpayer paid more than half the cost of keeping up a home for himself or herself and a qualifying person.
 - The qualifying person lived in the home for more than half the year.
 - The taxpayer's spouse did not live in the home during the last six months of the year.



A copy of Form 2441 and Schedule 2 can be found in the *Tax Forms Booklet Appendix,* which is part of your Publication 678 Package.

Qualifying Person

The child and dependent care expenses must be for at least one qualifying person.

A qualifying person is:

- A child that is under the age of 13 when the care is provided and for whom a dependency exemption can be claimed. (Special rules apply, however, if the parents are divorced or separated.)
- A dependent (or person who could be claimed as a dependent if his or her gross income had been less than \$3,000) who is physically or mentally incapable of self-care.
- A spouse who is physically or mentally incapable of self-care.

Example 1

Jim paid someone to care for his wife, Janet. Janet is physically unable to care for herself. Jim also paid to have someone prepare meals for his 13-year-old daughter, Jill.

Janet is a qualifying person, but Jill is not because she is not under 13.

Example 2

Ronald is unable to care for himself. His parents cannot claim him as a dependent only because Ronald earned \$3,000 during the year.

Ronald is a qualifying person. He would be claimed as a dependent if the gross income test had been met.

Example 3

Amanda is divorced and her 8-year-old daughter, Carrie, lives with her. In order to work, Amanda pays child care expenses for Carrie. Carrie's father claims a dependency exemption for her.

Carrie is a qualifying person. Amanda, the parent Carrie lives with, can claim the credit for child and dependent care expenses if the exception to the dependency exemption requirement for children of divorced or separated parents applies. Carrie's father cannot claim the credit if the exception applies.

Expenses for Care of Qualifying Person

To be work related, the expenses must be for the care of a qualifying person to allow the taxpayer to work or to look for work. Expenses are for the care of a qualifying person who is incapable of self-care are allowable only if their main purpose is the person's well-being and protection. The care can be provided in the taxpayer's home or outside the home if the 8 hours in the taxpayer's home requirement is met.

Tax Tips *******

It is physical custody (who the child lives with), not legal custody, that determines whether or not a taxpayer is eligible to claim the child care credit. It is not uncommon for physical custody to differ from legal custody.

POTENTIAL PITFALLS



If the taxpayer paid cash wages of **\$1,300** or more for the year to an employee working in the taxpayer's home, the taxpayer must pay the employment taxes on the employee's wages with Schedule H. attached to Form 1040. Taxpayers in this situation should seek paid professional tax assistance. This is beyond the scope of the VITA/TCE Program.

For more information, see Publication 926, Household Employer's Tax Guide.

TAX TIPS********

If the special rules for children of divorced or separated parents apply (discussed in Lesson 2), a child is a qualifying person of the custodial parent if a dependency exemption is not claimed because:

- The custodial parent signed Form 8332 to release claim to exemption, or
- The noncustodial parent provided at least \$600 under a pre-1985 divorce or separation agreement.

If the special rules apply, the child cannot be a qualifying child of the noncustodial parent.

The cost of care provided outside the taxpayer's home is counted if the care is for the taxpayer's dependent under the age of 13, or any other qualifying person who regularly spends at least 8 hours each day in the taxpayer's home.

Day-camp fees may be qualified expenses for this credit. Expenses for an overnight camp are not qualified expenses for this credit.

Expenses for care generally do not include amounts paid for food, clothing, entertainment or education. The total cost of sending a child to school can be counted only if:

- The child is in a grade level below the first grade, and
- The amount paid for food, and schooling is small and incidental to the child care and cannot be separated from the total cost of care.

If the child is in the first grade or higher, and the cost of schooling can be separated from the total cost, the taxpayer can divide the total cost between the cost of schooling and the cost of care. Only the cost of care can be counted. If the cost of care cannot be separated, no costs can be counted.

Earned Income

Generally, to claim the child and dependent care credit, the taxpayer (and spouse, if married) must have earned income during the year. Earned income *includes:*

- Wages, salaries, tips and other employee compensation,
- Net earnings from self-employment,
- Military basic quarters and subsistence allowances (including in-kind quarters and subsistence),
- Strike benefits,
- Disability payments that are reported as wages,
- Parsonage allowances,
- Military pay earned in a combat zone,
- Meals and lodging furnished for the convenience of the employer, and
- Voluntary salary deferrals.

Earned income does not include:

- Pensions or annuities,
- Social security payments,
- Workers' compensation,
- Interest,
- Dividends,
- Unemployment compensation,
- Scholarships, or fellowship grants except for amounts paid (and reported on Form W-2) for teaching, research or other services.

Limit on Expenses

The amount of expenses eligible for the credit is limited to the lowest of the following amounts for the year.

- The lower paid spouse's earned income (in the case of married taxpayers).
- The single taxpayer's earned income.
- The actual expenses paid.
- The overall limit of \$2,400 for one qualifying person or \$4,800 for two or more qualifying persons.

Some taxpayers receive **dependent care benefits** from their employers. If so, the overall limit of \$2,400/\$4,800 is reduced, dollar for dollar, by any reimbursement excluded from the taxpayer's income. The amount of dependent care benefits received is shown in box 10 of Form W-2.

Example 4

Mark earned \$14,000. His wife, Evelyn, earned \$5,600. Day care expenses for their three-year-old daughter were \$2,200.

The maximum amount of qualifying child care expenses is \$2,200. This is the lowest of:

- \blacksquare The lower paid spouse's earnings (\$5,600),
- The amount actually paid (\$2,200), and
- The overall limit for one qualifying person (\$2,400).

Example 5

Geraldine has one dependent child, Donald. Geraldine can claim the child and dependent care credit for Donald. Box 10 of her Form W-2 shows that Geraldine received \$1,400 during the year from her employer's dependent care assistance program.

Geraldine's overall expense limit is \$1,000 (\$2,400 minus \$1,400).

Nonworking Spouse

Married taxpayers usually must both work in order to claim the credit. However, if a spouse is either a full-time student during any five months of the year, or is incapable of self-care for some period during the year, a credit can be claimed. To figure the credit, the earned income for each month the spouse is either a full-time student or disabled is considered to be at least:

- \$200 with one qualifying person in the home, or
- \$400 with two or more qualifying persons in the home.

Example 6

Janice worked full time. Her husband, Ken, was a full-time student from January through May. Their son, Jason, was in daycare while Ken attended school.

Ken was a full-time student because he attended school for part of each of five months during the year (the five months need not have been consecutive). Ken's earned income for the time he attended school is considered to be \$1,000 (5 months X \$200).

Exercise 1

For the following situations, determine if the taxpayer can claim the credit for child and dependent care expenses, and if possible, determine the maximum amount eligible for the credit.

- **A.** Karen earned \$18,000. She paid \$1,800 for child care expenses for her four-year-old daughter, Crystal. If Karen can claim the credit, what is the maximum amount of child care expenses eligible for the credit?
- **B.** Andrea is married to Bill. They have a seven-year-old son, Charles. Charles lived with Andrea for the entire year. Andrea paid all the expenses of keeping the home they shared. Andrea also paid for before-school and after-school child care. Her total support for the child was \$1,800. Bill left the area 18 months ago. He did not live with Andrea at all during the year, but he did send \$1,200 in child support. Andrea and Bill will file separate returns. Bill will claim the dependency exemption for Charles. Can Andrea claim the credit for child and dependent care expenses?
- C. Ellen is divorced. She has custody of her 12-year-old daughter, Terri. Terri takes care of herself after school. In the summer, Ellen spends \$2,000 to send Terri away to overnight camp. What portion, if any, of the camp fees is eligible for the child and dependent care expenses credit?

Figuring the Credit

The credit is a percentage of qualifying expenses. For taxpayers with adjusted gross incomes of \$10,000 or less, the credit is 30 percent of qualifying expenses. As adjusted gross income increases, the percentage decreases. The lowest percentage is 20 percent. The tables on Schedule 2 (Form 1040A) and on Form 2441 show the percentage for each adjusted gross income bracket.

Completing Schedule 2 of Form 1040A or Form 2441 of Form 1040

This credit can be claimed on either Schedule 2 (Form 1040A) or Form 2441 (Form 1040). Complete the forms found in the instructions for Forms 1040A or 1040.

■ Part I – The taxpayer is required to identify all persons or organizations that provided care for the dependent or child. Enter the name, address, social security number (SSN) or employer identification number (EIN), and the amount paid to the person or organization that provided the care for the qualifying person during the year. (For taxpayers who received benefits under a dependent care benefits program, complete Part III before making any entries in Part II. Complete Part II for all taxpayers.)

If the care provider is not identified or the information is incomplete, the credit may be disallowed; but, if the taxpayer is able to show that he or she used due diligence in trying to furnish the necessary information, the taxpayer can still claim the credit.

Due diligence can be shown by getting and keeping the provider's completed Form W-10 or one of the following pieces of information.

- A copy of the provider's social security card.
- If the care was provided in a state where the driver's license includes the social security number, a copy of the provider's driver's license.
- A copy of the provider's completed Form W-4, if he or she is a household employee.
- A copy of the statement furnished by the taxpayer's employer, if the employer's dependent care plan is the provider.
- A letter or invoice from the provider if it shows the necessary information.
- Part II The child care credit is figured in this section of Schedule 2 or Form 2441. Enter the qualifying person(s) name, SSN, and the amount of qualified expenses paid on line 2 of Schedule 2 or Form 2441. Transfer the amount from Schedule 2, line 11, to Form 1040A, line 29. Transfer the amount from Form 2441, line 11, to Form 1040, line 46.
- **Part III** Complete this part only for taxpayers who received benefits under a dependent care benefits program.

Example 7

David A. and Edith B. Worth are married and file a joint return. Last year, they paid \$2,800 for the care of their son, Jonathan (SSN 000-00-2194). The payment was made to Karen's Kiddie Care, 456 Chester Avenue, Berlin, MD 25789 (EIN 10-6789101). The \$2,800 payment includes a \$1,000 dependent care benefit Edith received from her employer. Edith earned \$18,500 and David earned \$20,200 last year, working full time. Their adjusted gross income is \$38,700 and their tax liability is \$2,681. David's social security number is 000-00-2916. Exhibits 1 and 2 show the completed Schedule 2 (Form 1040A) for David and Edith.

POTENTIAL PITFALLS

The taxpaver must complete Part I of Schedule 2 or Form 2441. If the provider refuses to give their identifying information, the taxpayer should provide whatever information is available. and explain that the information was requested but the provider refused to give it. Taxpayers can use Form W-10. Dependent Care Provider's Identification and Certification. to aet the required information from the care provider.

tion is available,

POTENTIAL PITFALLS

Schedule 2 or Form 2441 must be filled out by all taxpayers with an entry in Box 10 of Form W-2, even if they do not claim the credit.

care provider.

POTENTIAL
PITFALLS
Schedule 2 or Form
2441 must be filled
out by all taxpayers
with an entry in
Box 10 of Form W-2,
even if they do not
claim the credit.

8-7

Department of the Treasury-Internal Revenue Service Schedule 2 Child and Dependent Care (Form 1040A) **Expenses for Form 1040A Filers** 2002 OMB No. 1545-0085 Name(s) shown on Form 1040A Your social security number David A. and Edith B. Worth 000:00:2935 Before you begin: You need to understand the following terms. See Definitions on page 1 of the separate instructions. Dependent Care Benefits Qualifying Person(s)
 Qualified Expenses • Earned Income (a) Care provider's (b) Address (number, street, apt. no., (c) Identifying (d) Amount paid Part I city, state, and ZIP code) number (SSN or EIN) (see instructions) 456 Chester Avenue Persons or 00 Karen's Kiddie Care 10-6789101 2,800 Berlin, MD 25789 organizations who provided the care (If you need more space, use the bottom of page 2.) You must complete this Complete only Part II below. part. Did you receive dependent care benefits? Complete Part III on the back next. Caution. If the care was provided in your home, you may owe employment taxes. If you do, you must use Form 1040. See Schedule H and its instructions for details. Information about your qualifying person(s). If you have more than two qualifying persons, see Part II the instructions. (c) Qualified expenses Credit for child (a) Qualifying person's name (b) Qualifying person's social you incurred and paid and dependent in 2002 for the person security number First Last listed in column (a) care expenses Worth 000 00 2194 1,800 Johnathan 3 Add the amounts in column (c) of line 2. Do not enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26. 3 1,400 00 4 Enter your earned income. 4 20,200 00 5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); all others, enter the amount from line 4. 5 18,500 00 6 Enter the smallest of line 3, 4, or 5. 6 1,400 00 7 Enter the amount from Form 1040A, line 22. 38,700 00 8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7. If line 7 is: If line 7 is: But not **But not** Decimal Decimal Over amount is Over amount is over over \$0-10,000 \$20,000-22,000 .30 .24 10,000—12,000 .29 22,000-24,000 .23 12,000—14,000 24,000-26,000 .22 .28 14,000—16,000 .27 26,000-28,000 .21 16,000-18,000 .26 28,000-No limit 25 18,000-20,000 8 \times . 20 9 Multiply line 6 by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions. 9 280 00 2,681 00 10 Enter the amount from Form 1040A, line 28. 10 Credit for child and dependent care expenses. Enter the smaller of line 9 or line 10 here and on Form 1040A, line 29. 280 00 11 Schedule 2 (Form 1040A) 2002 For Paperwork Reduction Act Notice, see Form 1040A instructions. Cat. No. 10749I

The Worths' Schedule 2, page 2

Fv h	m	٦ıt	-7

Schedule 2 (Form 104	0A) 200	2			-	age 2
Part III Dependent care benefits	12	Enter the total amount of dependent care benefits you received for 2002. This amount should be shown in box 10 of your W-2 form(s). Do not include amounts that were reported to you as wages in box 1 of Form(s) W-2.		12	1,000	00
	13	Enter the amount forfeited, if any. See the instructions.		13	0	00
	14	Subtract line 13 from line 12.		14	1,000	00
	15	Enter the total amount of qualified expenses incurred in 2002 for the care of the qualifying person(s). 15 2,800	00			
	16	Enter the smaller of line 14 or 15. 16 1,000	00			
	17	Enter your earned income . 17 20,200	00			
	18	If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5); if married filing a separate return, see the instructions for the amount to enter; all others, enter the amount from line 17.	00			
	19	Enter the smallest of line 16, 17, or 18. 19 1,000	00			
	20	Excluded benefits. Enter here the smaller of the following: ■ The amount from line 19 or ■ \$5,000 (\$2,500 if married filing a separate return and you were required to enter your spouse's earned income on line 18).		20	1,000	00
	21	Taxable benefits. Subtract line 20 from line 14. Also, include this amount on Form 1040A, line 7. In the space to the left of line 7, en "DCB."	ter	21	0	00
		To claim the child and dependent care credit, complete lines 22-26 below.				
	22	Enter \$2,400 (\$4,800 if two or more qualifying persons).		22	2,400	00
	23	Enter the amount from line 20.		23	1,000	00
	24	Subtract line 23 from line 22. If zero or less, stop. You cannot take the credit. Exception. If you paid 2001 expenses in 2002, see the instructions for line 9.		24	1,400	00
	25	Complete line 2 on the front of this schedule. Do not include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here.		25	1,800	00
	26	Enter the smaller of line 24 or 25. Also, enter this amount on line 3 on the front of this schedule and complete lines 4–11.		26	1,400	00
		·	Sc	hedule	2 (Form 1040A)	2002

Exercise 2

Sam L. and Sue D. Rock are married and file a joint return. Sam's social security number is 000-00-9832. The Rocks file Form 1040 because they itemize deductions. Their adjusted gross income is \$27,321 and their line 44 tax is \$748. Their earned income is \$27,100. Sam earned \$10,000 and Sue earned \$17,100. They have two children, Doug (SSN 000-00-2387), age 7, and Pebbles (SSN 000-00-3278), age 4, who lived with them all year. The children stayed at The Learning Center day care after school until their parents picked them up after work. The Learning Center is located at 496 White Road, Rancho Cordova, CA 95744. The Learning Center's tax identification number is 10-4487965. During 2002, total child care expenses for the Rocks was \$3,211. The Rocks paid \$2,200. Sue's employer paid \$1,011 under a dependent care benefits program.

- A. Prepare the Form 2441 for the Rocks.
- B. What amount is entered on Form 1040, line 46?

Lesson 8 8-9

2441	Uniid and	Dependent Car	re Expenses	OMB No. 1545-00
and the Tonas and the Tonas and		► Attach to Form 1040).	Attachment
artment of the Treasury nal Revenue Service (99)		► See separate instructi	ons.	Sequence No.
ne(s) shown on Form 1040				Your social security number
fore you begin: You r	need to understand th	e following terms. See	e Definitions on page	1 of the instructions.
Dependent Care Bene	efits • Qualifyi	ing Person(s)	Qualified Expenses	• Earned Inco
	ganizations Who Pro ore space, use the bot		must complete this p	part.
(a) Care provider's name	(number, street, ap	(b) Address t. no., city, state, and ZIP code	(c) Identifying no (SSN or EIN	
		10		
		No	Complete only Par	rt II below.
	Did you receive dent care benefits?	Yes —	Complete Part III	
	1 1 7			
			ent taxes. See the instruc	tions for Form 1040, line 60
	d and Dependent Ca r qualifying person(s). I	-	o qualifying persons, se	ee the instructions.
	Qualifying person's name		(b) Qualifying person's social	(c) Qualified expenses you incurred and paid in 2002 for
First		Last	security number	person listed in column (a)
			\(\tag{\pi}\)	
	olumn (c) of line 2. Do no t two or more persons. If			
from line 26	· · · · · · · · · ·		3	<i>"</i>
Enter your earned inc			4	
	eturn, enter your spouse's e instructions); all others ,			
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Enter the amount from	•	<u> 7 </u>		
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10,000—12,000	.29	22,000—24,000	.23	
12,000—14,000 14,000—16,000	.28 .27	24,000—26,000 26,000—28,000	.22 8 .21	× .
16,000—18,000	.26	28,000—26,000 28,000—No limit	.20	
18,000—20,000	.25	•		
10,000 20,000		R If you paid 2001 expe	nses in 2002, see	
Multiply line 6 by the the instructions			9	
Multiply line 6 by the of the instructions Enter the amount from			n 1040, line 45 . 10	
Multiply line 6 by the of the instructions Enter the amount from			n 1040, line 45 . 10	

Form 2441, page 2

Form	2441 (2002)	Page
Pa	rt III Dependent Care Benefits	
12	Enter the total amount of dependent care benefits you received for 2002. This amount should be shown in box 10 of your W-2 form(s). Do not include amounts that were reported to you as wages in box 1 of Form(s) W-2	
13	Enter the amount forfeited, if any (see the instructions)	
14	Subtract line 13 from line 12	
15	Enter the total amount of qualified expenses incurred in 2002 for the care of the qualifying person(s)	
16	Enter the smaller of line 14 or 15	
7	Enter your earned income	
18	If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5); if married filing a separate return, see the instructions for the amount to enter; all others, enter the amount from line 17	
19	Enter the smallest of line 16, 17, or 18 19	
20	Excluded benefits. Enter here the smaller of the following:	
21	The amount from line 19 or \$5,000 (\$2,500 if married filing a separate return and you were required to enter your spouse's earned income on line 18). Taxable benefits. Subtract line 20 from line 14. Also, include this amount on Form 1040, line 7. On the dotted line next to line 7, enter "DCB"	
	To claim the child and dependent care credit, complete lines 22-26 below.	
22	Enter \$2,400 (\$4,800 if two or more qualifying persons)	
23	Enter the amount from line 20	
4	Subtract line 23 from line 22. If zero or less, stop. You cannot take the credit. Exception. If you paid 2001 expenses in 2002, see the instructions for line 9	
.5	Complete line 2 on the front of this form. Do not include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here	
26	Enter the smaller of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11	
	⊗	Form 2441 (200

Lesson 8

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES Answers to Exercises

Exercise 1

- (A) \$1,800, which is the lowest of: earned income (\$18,000); the amount actually paid (\$1,800); and the limit for one qualifying person (\$2,400).
- (B) Yes.
- (C) None.

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES Answers to Exercises

Lesson 8

Exercise 2 The Rocks' Form 2441, page 1

orm 24 4	41	Child and	d Dependent (Jare E	:xpe	nses		OMB No. 1545-	0008
epartment of the T	Treasury		► Attach to Form					Attachment	•
ternal Revenue Se ame(s) shown o			► See separate instr	ructions.			Vour o	Sequence No.	
ine(s) snown c	Sa Sa	am L. and Sue D. R	ock					00 9832	ər
efore you	begin: You i	need to understand th	ne following terms.	See De	finitio	ns on page	1 of th	e instructions.	
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		ganizations Who Propre space, use the bo		You mus	st con	plete this p	oart.		
	provider's ame	(number, street, a	(b) Address pt. no., city, state, and ZIP	code)		(c) Identifying r (SSN or El		(d) Amount paid (see instructions	
he Learn	ning Center	496 White Road Rancho Cordova,	CA 95744			10-4487	965	3,211	00
					W				
					<u> </u>				l
		Did you receive	No —	-	Comp	lete only Pa	rt II belo	w.	
	depen	ident care benefits?	Yes —		Comp	lete Part III	on the b	ack next.	
Caution.	. If the care wa	s provided in your home	, you may owe emplo	yment ta	xes. Se	e the instruc	tions for	Form 1040, line	60.
art II Cr	redit for Chil	d and Dependent Ca	are Expenses						
Informat		r qualifying person(s). Qualifying person's name	If you have more tha					structions. Qualified expenses y	,OII
	First	Qualitying person's name	Last		security	person's social number	incurre	d and paid in 2002 for son listed in column	or the
oug		Rock		000	00	2387		1,100	00
ebbles		Rock		000	00	3278		1,100	00
		olumn (c) of line 2. Do no							
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		eturn, enter your spouse'				student		חחו מו	00
		e instructions); all others	s, enter the amount fro	m line 4		5		17,100	_
	ne smallest of	, ,			OP 70	6 31 00		2,200	00
		n Form 1040, line 36 cimal amount shown be				V///			
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1: 1: 1: 1: Multiply the instr	0,000—12,000 2,000—14,000 4,000—16,000 6,000—18,000 8,000—20,000 I line 6 by the ructions ae amount fron	.28 .27 .26 .25 decimal amount on line	26,000—28,00 28,000—No li 8. If you paid 2001 e inus any amount on l	00 mit expenses Form 104	.20 in 200 40, line	2, see 9 45 . 10			00

Lesson 8

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES Answers to Exercises

Exercise 2 The Rocks' Form 2441, page 2

orm	2441 (2002)		F	Page 2
Pai	t III Dependent Care Benefits			
2	Enter the total amount of dependent care benefits you received for 2002. This amount should be shown in box 10 of your W-2 form(s). Do not include amounts that were reported to you as wages in box 1 of Form(s) W-2	12	1,011	00
3	Enter the amount forfeited, if any (see the instructions)	13	0	00
4	Subtract line 13 from line 12	14	1,011	00
5	Enter the total amount of qualified expenses incurred in 2002 for the care of the qualifying person(s) 15			
6	Enter the smaller of line 14 or 15			
7	Enter your earned income			
8	If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5); if married filing a separate return, see the instructions for the amount to enter; all others, enter the amount from line 17			
9	Enter the smallest of line 16, 17, or 18			
0	Excluded benefits. Enter here the smaller of the following:			
	The amount from line 19 or \$5,000 (\$2,500 if married filing a separate return and you were required to enter your spouse's earned income on line 18).	20	1,011	00
1	Taxable benefits. Subtract line 20 from line 14. Also, include this amount on Form 1040, line 7. On the dotted line next to line 7, enter "DCB"	21	0	00
	To claim the child and dependent care credit, complete lines 22-26 below.			
2	Enter \$2,400 (\$4,800 if two or more qualifying persons)	22	4,800	00
3	Enter the amount from line 20	23	1,011	00
1	Subtract line 23 from line 22. If zero or less, stop. You cannot take the credit. Exception. If you paid 2001 expenses in 2002, see the instructions for line 9	24	3,789	00
5	Complete line 2 on the front of this form. Do not include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here	25	2,200	oc
6	Enter the smaller of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11	26	2,200	00
			Form 2441	(2002

Exercise 2

(B) Form 1040, line 46: \$462.

EDUCATION CREDITS

Lesson 9

Introduction and Objectives

In this lesson you will learn about the education credits. The Hope scholarship credit and the Lifetime Learning Credit cannot both be claimed on the same student in a tax year.

After completing this lesson, you should be able to:

- Calculate the Hope Credit on Form 8863.
- Calculate the Lifetime Learning credit on Form 8863.

GENERAL REQUIREMENTS

Taxpayers can claim the **Hope Scholarship Credit** (Hope credit) and the **Lifetime Learning Credit** for higher education expenses paid in 2002 for an eligible student. Both credits are nonrefundable and can be claimed on either Form 1040 or Form 1040A. These two credits are also called *education credits*.

To claim either of the education credits the taxpayer must:

- Meet all of the general requirements,
- Meet all of the specific requirements for the individual credit, and
- Meet the income limits.

The general requirements provide that the taxpayer must have incurred *qualified expenses* for an *eligible student* to attend *an eligible educational institution* during the tax year. Additionally, the general requirements set limits on the modified adjusted gross income of the taxpayer.

POTENTIAL PITFALLS



If a student receives a tax-free distribution from a Coverdell education savings account for the tax year, he or she can claim an education credit, as long as the distribution is not used to pay the same expenses. For more information, see Publications 590 and 970.

TAX TIPS

Taxpayers may not take the Tuition and Fees Deduction and the Hope or lifetime learning credit for the same student.

If a taxpayer has qualified tuition and fees, it is usually to the taxpayer's benefit to take the above the line deduction.

Qualified Expenses

The Hope credit and the lifetime learning credit are based on qualified tuition and related expenses the taxpayer pays for himself or herself, the taxpayer's spouse, or dependents the taxpayer claims on his or her tax return.

Qualified tuition and related expenses are tuition and fees required for enrollment or attendance at an eligible educational institution and generally *include fees for:*

- Course-related books, supplies and equipment, and
- Student activities.

The fees must be paid *to the institution* as a condition of enrollment or attendance.

Qualified tuition and related expenses *do not include* the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation or similar personal, living, or family expenses, *even if* the fees must be paid to the institution as a condition of enrollment or attendance.

When considering qualified tuition and related expenses for the Hope credit, the cost of courses for athletics, sports, games, hobbies or noncredit courses are not used unless the course is part of the student's degree program. However, when computing the qualified tuition and related expenses for the lifetime learning credit, these types of expenses are includible if the course was taken to acquire or improve the job skills of the student.

If a taxpayer *prepaid* qualified tuition and related expenses for an academic period that begins in the first three months of the following year, he or she can use the prepaid amount in figuring the credit.

Example 1

Thomas pays \$1,500 in December 2002 for qualified tuition for the winter semester that begins in January 2003. He can use the \$1,500 paid in December of 2002 to compute his credit for 2002.

Payments with borrowed funds.

Taxpayers can claim the Hope credit and lifetime learning credit for qualified tuition and related expenses paid with the proceeds of a loan. Use the expenses to figure the credit for the year in which the expenses are paid, not the year in which the loan is repaid.

Eligible Student

The taxpayer, the taxpayer's spouse, or the taxpayer's dependent (for whom the taxpayer claims a dependency exemption) can be an eligible student.

In addition, for the Hope credit, the student must be:

- Enrolled in a program that leads to a degree, certificate or other recognized educational credential.
- Taking at least one-half of the normal full-time workload for his or her course of study for at least one academic period beginning during the calendar year.
- Enrolled for one of the first two years of his or her postsecondary education.
- Free of any felony conviction for possessing or distributing a controlled substance.

Eligible Educational Institution

An eligible educational institution is generally any accredited public, nonprofit, or proprietary (private) postsecondary institution eligible to participate in the student aid programs administered by the Department of Education. Most universities and colleges, including community colleges, meet these requirements.

An eligible educational institution (such as a college or university) that receives payment of qualified tuition and related expenses generally must issue **Form 1098–T**, *Tuition Payments Statement*, to each student by February 1, of each year. The information on Form 1098–T will help you determine whether the taxpayer can claim an education credit for 2002. The following information should be included on the 2002 form.

- The name, address, and taxpayer identification number of the educational institution.
- The name, address, and taxpayer identification number of the student.
- Whether the student was enrolled for at least half of the full-time academic workload, box 4.
- Whether the student was enrolled exclusively in a graduate-level program, box 5.

Income Requirements

The Hope credit and the lifetime learning credit are phased out (gradually reduced) if the taxpayer's modified AGI is over \$41,000 (over \$82,000 if married filing jointly). If a taxpayer's modified AGI is \$51,000 or more (\$102,000 or more if married filing jointly), no credit is allowed. Education credits are not allowed to persons who are married filing separately.

POTENTIAL PITFALLS



Prepaid expenses do not change the fact that only payments made during this tax year can be used to claim an education credit for this tax year.

Modified Adjusted Gross Income (MAGI)

For most taxpayers, modified adjusted gross income (MAGI) is adjusted gross income (AGI) as figured on their federal income tax return. MAGI when using Form 1040A is the AGI on line 21 of that form. MAGI when using Form 1040 is the AGI on line 35 of that form, modified by adding back any:

- 1) Foreign earned income exclusion
- 2) Foreign housing exclusion
- 3) Exclusion of income for bona fide residents of America Samoa, and
- 4) Exclusion of income from Puerto Rico.

HOPE CREDIT

A Hope credit can be claimed for *each* eligible student that is claimed on the taxpayer's return.

Credit Amounts

The Hope credit is figured on Form 8863, *Education Credits* (*Hope and Lifetime Learning Credits*). The maximum Hope credit is \$1,500 *per student* for each of the first two taxable years of his or her postsecondary education. For each eligible student who qualifies for the Hope credit:

- If the expenses are \$1,000 or less, the credit is the amount of the expenses,
- If the expenses are \$2,000 or more, the credit is \$1,500, and
- If the expenses are between \$1,000 and \$2,000, the credit is \$1,000 plus one-half of the expenses over \$1,000. For example, if the expenses are \$1,500, the credit is \$1,250 (\$1,000 plus one-half of \$500).

Example 2

John and Mary Green have a dependent son, Jim, who is a freshman at the local university. They paid \$4,500 in qualified tuition expenses. They determined it would be more beneficial to them to take the Hope Credit rather than the Tuition and Fees Deduction. Their Form 8863 is shown in Exhibit 1.

Education Credits (Hope and Lifetime Learning Credits)

Department of the Treasury Internal Revenue Service ► See instructions.

► Attach to Form 1040 or Form 1040A.

OMB No. 1545-1618 Attachment Sequence No. **50**

Name	(s) shown on return									Your s	ocial security nu	mber
		n and Mary Gr									00 98	
Pa	t Hope Credit. Ca	ution: The Hope cre	dit may be cla	imed	for no i	more	than	2 tax y	years f	or the	same studer	nt.
1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (but do not enter more th \$2,000 for ea student). Se instructions	t nan ich	colum	r of tunt in	he	colur	Subtra nn (d) f	rom	(f) Enter one of the amoun column (e	nt in
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LIFETIME LEARNING CREDIT

The lifetime learning credit is based on the total qualified education expenses paid by the taxpayer and not on the number of eligible students. Education expenses are qualified for the lifetime learning credit if they are:

- For courses taken as part of a postsecondary degree program, or
- For courses that are not part of a postsecondary degree program, but that are taken to improve or acquire job skills.

Example 3

Samantha, a professional photographer, enrolls in an advanced photography course at a local community college. Although the course is not part of a degree program, she enrolls in it to improve her job skills. The course fee paid by Samantha is considered qualified tuition for the purpose of claiming the lifetime learning credit.

Example 4

Cleve, an engineer, plans to vacation in Europe next year. In preparation for the trip, he enrolls in a noncredit photography class at a local community college. Because Cleve is not taking the course as part of a degree program or to acquire or improve his job skills, the cost of the course is not a qualifying expense for claiming the lifetime learning credit.

Credit amounts

The lifetime learning credit is also figured on Form 8863. The maximum amount of the credit is \$1,000 per taxpayer for all eligible students. The credit amount is figured by multiplying total qualified educational expenses, up to \$5,000, by 20%.

Example 5

Judy Green is single and took a course at the local college to recertify her to teach in public schools. Her qualified tuition expenses were \$500. She chooses to take the lifetime learning credit rather than the Tuition and Fees Deduction. Her completed Form 8863 is shown in Exhibit 2.

Judy's Form 8863 Exhibit 2

Form **8863**

Education Credits (Hope and Lifetime Learning Credits)

OMB No. 1545-1618 9**00**

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For F	Paperwork Reduct	ion Act N	lotice, see n	age 3.			Cat.	No. 25	5379M				Form 8863	(2002)

No Double Benefits

A taxpayer cannot:

- Deduct higher education expenses and claim a credit based on those same expenses,
- Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses, or
- Claim a credit based on expenses paid with tax-free scholarship, grant, employer-provided educational assistance or a distribution from a Coverdell ESA.

However, a taxpayer can claim a credit based on expenses paid with the eligible student's earnings, loans, gifts, inheritances, or personal savings.

An eligible student cannot claim an education credit if he or she is claimed as a dependent on another taxpayer's tax return. Any amounts paid by the student are considered paid by the taxpayer who claims the student as a dependent.

The following table summarizes the differences between the credits.

Table: Comparison of Education Credits

Lifetime Learning Credit	Hope Scholarship Credit
per taxpayer credit	per eligible student credit
\$1,000 limit per taxpayer	\$1,500 limit per eligible student
available for an unlimited number of years	available ONLY for the first two years of postsecondary education
credit available for courses taken as part of a postsecondary degree program or to acquire or improve job skills (including noncredit courses and graduate level work)	must be pursuing a degree or other educational credential
available for one or more courses	must take at least 1/2 of the normal full-time workload for one academic period
no other restrictions	felony drug conviction restriction

Exercise 1

Bruce and Toni are married and file a joint tax return. For 2002, their modified AGI (\$50,000) is the same as their AGI and their tax is \$4,826. Toni (SSN 000-00-6941) is attending the local community college (an eligible institution) part time to earn credits toward an associate's degree in nursing. She already has a bachelor's degree in history and wants to become a nurse. In August 2002, Toni paid \$4,000 for her fall 2002 semester. Bruce and Toni choose to take the lifetime learning credit. They claim no other credits. Complete their Form 8863.

TAXWISE HINTS

To input qualified tuition expenses and prepare a Form 8863 using TaxWise, select Form 8863, enter the student's name in either the Hope credit section or the lifetime learning credit section and complete all the entries annotated in red. TaxWise will automatically complete the form and carry the mathematical calculations to the Form 1040.

▶▶ SUMMING UP THIS LESSON ◀◀

The Hope and lifetime learning credits are nonrefundable credits that allow a taxpayer to claim all or a portion of qualified tuition and related expenses paid for post-secondary education.

Generally, a taxpayer can claim the Hope or lifetime learning credit if they pay qualified tuition and related expenses of higher education for an eligible student who is either the taxpayer, the taxpayer's spouse, or a dependent whom the taxpayer can claim an exemption on his or her tax return.

A taxpayer cannot:

- ➤ Deduct higher education expenses on his or her tax return and also claim a Hope or lifetime learning credit based on those same expenses,
- ➤ Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses, or
- ► Claim a credit based on expenses paid with tax-free scholarship, grant, or employer-provided educational assistance.

The Hope and lifetime learning credits are claimed on Form 8863 which can be filed with either Form 1040 or Form 1040A.

Education Credits (Hone and Lifetime Learning Credits)

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For	Paperwork Reduct	ion Act N	lotice, see page 3.		Cat. No. 25	5379M		Form 8863	(2002)

9-10 Lesson 9

Exercise 1 Bruce and Toni's Form 8863

Education Credits (Hope and Lifetime Learning Credits)

OMB No. 1545-1618

Attachment

Department of the Treasury See instructions. ► Attach to Form 1040 or Form 1040A. Sequence No. 50 Internal Revenue Service Name(s) shown on return Your social security number Bruce and Toni Green 000:00:9541 Part I Hope Credit. Caution: The Hope credit may be claimed for no more than 2 tax years for the same student. (c) Qualified (d) Enter the (a) Student's name (b) Student's expenses (as shown on page 1 social security (but do not smaller of the (e) Subtract (f) Enter one-half number (as amount in column (d) from of the amount in of your tax return) enter more than shown on page 1 \$2,000 for each column (c) or column (c) column (e) First name student). See \$1,000 of your tax return) Last name instructions Add the amounts in columns (d) and (f) 2 Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit, go to Part II; otherwise, go to Part III Lifetime Learning Credit Part II (a) Student's name (as shown on page 1 (b) Student's social security (c) Qualified number (as shown on page expenses. See of your tax return) instructions Caution: You First name Last name 1 of your tax return) cannot take the Toni 000 00 6941 4000 00 Green Hope credit and the lifetime learning credit for the same student. 5 4000 00 Add the amounts on line 4, column (c), and enter the total Enter the **smaller** of line 5 or \$5.000 6 4000 00 Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III 800 00 Part III Allowable Education Credits Tentative education credits. Add lines 3 and 7 8 800 00 Enter: \$102,000 if married filing jointly; \$51,000 if single, head of 102,000 00 9 household, or qualifying widow $\bar{\text{(er)}}$ 10 50,000 00 Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)* Subtract line 10 from line 9. If line 10 is equal to or more than 11 52,000 00 Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er) 12 20,000 00 If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as 13 14 800 00 15 4826 00 15 Enter the amount from Form 1040, line 44 (or Form 1040A, line 28) 16 Enter the total, if any, of your credits from Form 1040, lines 45 through 47 (or from 16 0 00 Subtract line 16 from line 15. If line 16 is equal to or more than line 15, stop; you cannot 17 4826 00 Education credits. Enter the smaller of line 14 or line 17 here and on Form 1040, 18 800 00 *See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico. For Paperwork Reduction Act Notice, see page 3. Cat. No. 25379M Form **8863** (2002)

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EARNED INCOME CREDIT

Lesson 10

Introduction and Objectives

In this lesson you will learn about the earned income tax credit. This is a refundable credit, and taxpayers must file a tax return to receive the credit. Beginning in 2002, some of the rules and qualifications for earned income tax credit changed. New rules and/or qualifications apply to earned income, modified adjusted gross income, taxpayers with the same qualifying child, and a new definition of foster child.

After completing this lesson you should be able to:

- Use the new 2002 rules to determine which taxpayers are eligible for the earned income credit.
- Calculate and report the credit using the EIC worksheet.
- Explain the benefits of the Advanced Earned Income Credit (AEIC).
- Report the AEIC on the tax return.

GENERAL REQUIREMENTS

Some taxpayers are able to claim the earned income credit. This is a refundable credit, and eligible taxpayers can receive a refund of this credit even if they owe no tax and had no income tax withheld.

All taxpayers (and spouses, if filing a joint return) must meet the general requirements to claim the credit. Other requirements apply depending on whether or not the taxpayer has a qualifying child (defined later).

TAX TIPS

Taxpayers who are eligible to claim the earned income credit should file a tax return even if they are not otherwise required to file.

POTENTIAL PITFALLS



If the taxpayer's filing status is married filing separately, the taxpayer cannot claim the earned income credit. Generally, to claim the earned income tax credit, a taxpayer must:

- Have earned income during the year,
- Not have investment income of more than \$2,550. Investment income includes taxable interest and dividends, tax exempt interest, capital gain net income, net income from rents and royalties not derived from a trade or business, and net income from passive activities,
- Use any filing status except married filing a separate return,
- Have a tax return that covers a 12-month period. This does not apply if a short period return is filed because of an individual's death,
- Show on the tax return the SSN of the taxpayer (and spouse if filing a joint return). See identification numbers, later.
- Not be the qualifying child of another person,
- Not exclude from gross income any income earned in foreign countries, or deduct or exclude a foreign housing amount (File Form 2555 or Form 2555-EZ), and
- Not be a nonresident alien. Nonresident aliens may qualify for the credit only if they are married to a U.S. citizen or resident *and* their filing status is married filing jointly.

Identification Numbers

To claim the EIC, the taxpayer (and spouse if filing a joint return) must have a valid Social Security number (SSN) issued by the Social Security Administration (SSA). Any qualifying child listed on Schedule EIC must also have a valid SSN. If a social security card has a legend that says "Not valid for employment" and the number was issued so that the taxpayer (or spouse or qualifying child) could receive a federally funded benefit, the taxpayer cannot claim the EIC. An example of a federally funded benefit is Medicaid.

Individual Taxpayer Identification Numbers (ITINs) and Adoption Taxpayer Identification Numbers (ATINs) cannot be used when claiming the EIC.

If a taxpayer has a social security card that contains the legend "valid for work only with INS authorization," the taxpayer may claim the credit, assuming he or she meets the other requirements.

Taxpayers With One or More Qualifying Children

If the taxpayer has a qualifying child (defined later), the following additional requirements apply.

- The taxpayer's earned income and adjusted gross income must each be less than:
 - b) \$33,178 (\$34,178 if married filing jointly) if he or she has more than one qualifying child,
 - a) \$29,201 (\$30,201 if married filing jointly) if he or she has one qualifying child, or
- The taxpayer must show on Schedule EIC the name, age, and SSN for each qualifying child listed (see *Identification Numbers*, earlier).

Taxpayers With No Qualifying Child

If the taxpayer does not have a qualifying child, the following additional requirements apply.

- The taxpayer's earned income and adjusted gross income must each be less than \$11,060 (\$12,060 if married filing jointly).
- The taxpayer (or the taxpayer's spouse, if filing a joint return) must be at least age 25 but under age 65 at the end of the year.
- Neither the taxpayer (nor the taxpayer's spouse if filing jointly) can be eligible to be claimed as a dependent on another person's return.
- The principal place of abode of the taxpayer (and the taxpayer's spouse, if filing jointly) must be in the United States for more than half the year.

Earned Income

Earned income is wages, salaries, tips and other employee compensation, but only if the amounts are includible in gross income; plus net earnings from self-employment. Table 1 provides examples of what to include and not to include as earned income in computing the earned income credit.

Amounts received for work performed while an inmate in a penal institution are not considered earned income for purposes of the earned income credit. Enter "PRI" and the amount of the income earned while an inmate next to line 7 (Form 1040 or 1040A) or line 1 (Form 1040 EZ). This income is still considered taxable for purposes of determining the taxpayer's federal income tax.

If the taxpayer was a household employee who did not receive a Form W-2 because he or she was paid less than \$1,300, the income must still be included on line 7 (Form 1040A or 1040) or line 1 (Form 1040EZ). Enter "HSH" and the amount not reported on Form W-2 next to line 7 (Form 1040A or 1040) or Line 1 (Form 1040EZ).

Table 1. Examples of Earned Income for the Earned Income Credit

Earned Income Includes Does not include

Tax Tips

Nontaxable earned income is no longer considered for eligibility of EIC.

Taxable wages, Interest and dividends salaries, and tips

Taxable long-term

disability benefits

Net earnings from

Gross income of a statutory employee

self-employment

received prior to min-

imum retirement age

Social Security and railroad retirement bene-Union strike benefits | fits

Welfare benefits

Workfare payments

Pensions or annuities

Veteran's benefits (including VA rehabilitation payments)

Workers' compensation benefits

Alimony

Child Support

Nontaxable foster care payments

Unemployment compensation

Taxable scholarship or fellowship grants that are not reported on Form W-2

Earnings for work performed while an inmate at a penal institution

Salary deferrals (for example, under a 401(k) or 403(b) plan or the Federal Thrift Savings Plan)

Combat zone excluded pay (box 12, code Q of Form W-2)

Basic housing and subsistence allowances for the U.S. Military (box 12, code Q of Form W-2)

The value of meals or lodging provided by an employer for the convenience of the employer

Housing allowance or rental value of a parsonage for the clergy

Excludable dependent care benefits (line 18 of either Form 2441, Form 1040, or Schedule 2, Form 1040A)

Salary reductions such as under a cafeteria plan

Excludable employer provided educational assistance benefits (may be shown in box 13 of Form W-2)

Anything else of value received from someone for services performed, if it is not currently taxable

QUALIFYING CHILD

For purposes of the earned income credit, a taxpayer has a qualifying child, if the child meets three tests.

- Relationship Test
- Residency Test, and
- Age Test

Relationship Test

To meet the relationship test, the qualifying child must be the taxpayer's:

- 1. Son, daughter, stepson, stepdaughter or a descendant of the taxpayer's son, daughter, stepson, or stepdaughter.
- 2. Brother, sister, stepbrother, stepsister. The taxpayer must care for any of these children as his or her own child. A descendant must be lineal descendant.
- 3. Eligible foster child.

An *eligible foster child* is a child placed with the taxpayer by an authorized placement agency and whom the taxpayer cares for as his or her own child. An authorized placement agency is an agency of a state or political subdivision of a state, including a court, or tax-exempt organization licensed by the state.

An adopted child (and a child placed with the taxpayer for adoption) is treated as a child by blood.

Residency Test

To meet the residency test, the child must live with the taxpayer in the United States for more than half of the tax year. If a child fails to meet the residency test because the child was born or died during the year, the child is considered to meet the test if the child lived with the taxpayer while the child was alive.

Age Test

To meet the age test, the child must be:

- Under age 19 at the end of the year,
- A full-time student under age 24 at the end of year, or
- Permanently and totally disabled at any time during the tax year, regardless of age.

A *married taxpayer* can be a qualifying child of the taxpayer if he or she can be claimed as a dependent by the taxpayer.

TAX TIPS

The taxpayer does
not need to have a
home. It is sufficient
if the taxpayer and
child live together in
a series of homeless

shelters.

Qualifying Child of More Than One Taxpayer

Beginning with tax year 2002, if a child is a qualifying child of more than one taxpayer, the taxpayers may choose which of them will claim the credit on the basis of that child. If two or more children are qualifying children of the same taxpayers (not filing a joint return together), the taxpayers may agree that one will claim the credit on the basis of one child and the other will claim the credit on the basis of the other child.

Example 1

Jane (age 30) is unmarried. In 2002, Jane lived with her four children and her mother, Linda. Provided they each meet the eligibility and income requirements, Jane may claim the EIC based on one or two of the children, and Linda may claim the EIC based on any other children not claimed by Jane.

If two or more taxpayers actually claim the credit on the basis of the same qualifying child, the statute determines which of them is entitled to the credit on the basis of that child. This is the tie-breaker rule. The taxpayer who is entitled to the credit is –

- The parent, if one taxpayer is a parent of the child.
- The taxpayer with the higher AGI, if neither is a parent of the child.
- The parent the child lived with longest during the tax year, if both taxpayers are parents of the child and they do not file a joint return together.
- The parent with the higher AGI, if both taxpayers are parents of the child, the child lived with both parents for the same length of time during the tax year, and they do not file a joint return together.

Example 2

John (age 26) is unmarried. In 2002, John and his daughter, Lynn, lived with John's father, Paul. John's sole income was wages of \$19,000. Paul's sole income was wages of \$12,000.

Lynn is a qualifying child of both John and Paul. John and Paul agree that Paul will claim the EIC on the basis of Lynn, because Paul's credit would be more than John's. If John later decides to claim the credit, under the tie-breaker rule, Paul will lose the credit he claimed.

Example3

Ralph is single and has two qualifying children. He earned \$23,247 in taxable wages and his adjusted gross income is \$26,928.

Ralph can claim the earned income credit because his earned income and adjusted gross income are each less than \$33,178.

Example 4

Maureen has \$23,050 in earned income; her adjusted gross income is \$23,175. Her filing status is single. Maureen's 20-year-old daughter, Angie, lived with her for eight months of the year. Angie is not married and is a full-time college student.

Maureen can claim the earned income credit because she has a qualifying child and her earned income and adjusted gross income are under \$29,201.

Disallowed Earned Income Credit

If a taxpayer's earned income credit was disallowed in a prior year as a result of the deficiency procedures, he or she cannot claim the credit again unless *Form 8862*, *Information To Claim Earned Income Credit After Disallowance*, is attached to the return. If the credit is claimed without attaching Form 8862, it will be automatically denied, under the math error procedures.

A deficiency procedure occurs when the IRS questions the taxpayer's eligibility for the earned income credit for reasons other than a mathematical or clerical error. If the credit was disallowed in the earlier year because of a mathematical or clerical error, Form 8862 should not be completed. For more information on deficiency procedures, see Publication 596.

A taxpayer who is determined to have claimed the EIC due to reckless or intentional disregard of rules or regulations is ineligible to claim the EIC for a subsequent period of 2 years.

A taxpayer who is determined to have fraudulently claimed the EIC is ineligible to claim the EIC for a subsequent period of 10 years.

Exercise 1

Determine if the taxpayers in this exercise can claim the earned income credit. If they cannot, explain why.

- **A.** Sharon has an eligible foster child, Eric. Eric is 12 years old and began living with Sharon in August 2002. Sharon's earned income and her adjusted gross income are \$14,275. Can Sharon claim the earned income credit?
- **B.** Doug and Donna are married and live together. Their combined earned income is \$22,222. Doug reports adjusted gross income of \$10,728 on his separate tax return, and Donna reports adjusted gross income of \$11,514 on her separate return. Sam, their four-year-old son, lives with Doug and Donna. Can Doug and/or Donna claim the earned income credit?
- C. Randy and Cara were married and lived together until August when they divorced. Randy and Cara have two children, Jimmy, age seven, and Anna, age five. The children lived with both of their parents until August, then they lived with their mother. Randy's earned income and adjusted gross income are \$19,251. Cara's earned income is \$14,751, and her adjusted gross income is \$15,362. Can Randy and/or Cara claim the earned income credit?
- **D.** Benjamin, age 26, lives alone, is single, and earns \$8,250. His adjusted gross income is \$8,950. Can Benjamin claim the earned income credit?
- **E.** Melanie is 18 years old and married. Melanie's husband is overseas, and she lives with her mother, Susan. Susan's earned income is \$18,431, and her adjusted gross income is \$18,453. Susan cannot claim Melanie as a dependent. Can Susan claim the earned income credit?
- **F.** Circle the items that are considered earned income for earned income credit purposes.
 - 1. Wages
 - **2.** Housing allowance for a member of the clergy
 - **3.** Social security benefits
 - 4. Interest income
 - **5.** Unemployment compensation
 - **6.** Tip income
 - 7. Dividend income
 - 8. Military subsistence allowances

THE EARNED INCOME CREDIT WORKSHEET AND SCHEDULE EIC

The earned income credit is computed on the Earned Income Credit (EIC) Worksheet. Before completing the EIC Worksheet, *you must* complete the steps in the EIC instructions line 64 of Form 1040; line 41 of Form 1040A; or line 8 of Form 1040EZ.

Completing the steps will help you determine whether or not the taxpayer is eligible to take the credit. If the taxpayer can claim the earned income credit, complete the EIC Worksheet. If the taxpayer is not eligible to claim the credit, write "No" next to line 8 of 1040EZ; line 41 of 1040A; or line 64 of 1040. *The steps and the EIC Worksheets are included in the Tax Forms Booklet Appendix, and the Forms 1040, 1040A, and 1040EZ instructions.*

There are two versions (A and B) of the EIC Worksheet for Form 1040 filers. (The sidebar on this page alerts you to when Version B applies). Complete the EIC Worksheet to determine the amount of the earned income credit the taxpayer can claim. The EIC Worksheet should not be attached to the return; the taxpayer should keep it with his or her tax records.

Using the Earned Income Credit Table

The Earned Income Credit (EIC) Table is used to determine the amount of the credit. The tables are found in the instructions for Forms 1040EZ, 1040A, or 1040.

When using the earned income credit table to determine the credit, read down the columns labeled *At least* . . . *But less than* and find the line that includes the amount you are instructed to look up from the EIC Worksheet. Read across to the column that includes the number of qualifying children of the taxpayer and filing status. Enter the earned income credit from that column on the EIC Worksheet.

Example 5

Roger's filing status is head of household and he has two qualifying children. The amount shown on lines 1 and 3 of his Form 1040A EIC Worksheet is \$19,300.

Roger's earned income credit from the EIC Table is \$2,917.

ALERT



The EIC Worksheet for Form 1040 has two versions, A and B. They are both included in the Tax Forms Booklet Appendix.

If the taxpayer was self-employed or reported income and expenses on Schedule C or C-EZ as a statutory employee, he or she must use the EIC Worksheet B to figure his or her credit amount.

TAX TIPS

The Earned Income
Credit (EIC) Table is
included in the Tax
Forms Booklet
Appendix.

POTENTIAL PITFALLS



Errors are easily made when using the earned income credit table. To ensure that you have entered the correct amount on the tax form, look up the credit twice—once before you enter the credit on the form and once after you have entered it on the form.

TAX TIPS

Schedule EIC is included in the Tax
Forms Booklet
Appendix.

Exercise 2

A. Alex and Cheryl have two qualifying children. Their filing status is married filing jointly. The amount shown on lines 1 and 3 of their EIC Worksheet is \$19,866.

What is the earned income credit from the EIC Table? ____

B. Roxanne is divorced. She lives with her infant daughter. The amount shown on lines 1 and 3 of her EIC Worksheet is \$17,750.

What is the earned income credit from the EIC Table? _____

Completing Schedule EIC

Qualifying Child Information

Schedule EIC, *Earned Income Credit*, contains only information about qualifying children. Only taxpayers who have a qualifying child must fill out the schedule and attach it to Form 1040A or Form 1040.

Example 6

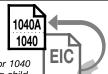
Ronald Evans (SSN 000-00-9840) is single. His son, Harry (SSN 000-00-9849), was born in 1979. Harry lived with Ronald during all of 2002. Harry is a full-time student. Harry is not married and is a qualifying child of his father. He is not a qualifying child of his mother. However, Harry's mother claims him as a dependent on her tax return.

Exhibit 1 shows the Schedule EIC.

SCHEDULE EIC (Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

2002

Attachment Sequence No. 43 Your social security number

Department of the Treasury Internal Revenue Service (99) Complete and attach to Form 1040A or 1040 only if you have a qualifying child.

Name(s) shown on return Ronald Evans

For Paperwork Reduction Act Notice, see Form 1040A

or 1040 instructions.

Evans | 000 :00 :9840 | See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that

Before you begin: See to

(a) you can take the EIC and (b) you have a qualifying child.

 If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up



- to 10 years. See back of schedule for details.

 It will take us longer to process your return and issue your refund if you do not fill in all lines that apply
- for each qualifying child.
 Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Q	ualifying Child Information	0	Child 1	Child 2			
1	Child's name If you have more than two qualifying children, you only have to list two to get the maximum credit.	First name Harry	Last name Evans	First name	Last name		
2	Child's SSN The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter 'Died" on this line and attach a copy of the child's birth certificate.	000	i				
3	Child's year of birth		9 7 9 r 1983, skip lines 4a to line 5.	Year If born after 1983, skip lines 4a and 4b; go to line 5.			
_	If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student?	X Yes. Go to line 5	No. Continue	Yes. Go to line 5.	No. Continue		
k	Was the child permanently and totally disabled during any part of 2002?	Yes.	No. The child is not a qualifying child.	Yes.	No. The child is not a qualifying child.		
5	Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)	Son					
6	Number of months child lived with you in the United States during 2002						
	 If the child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 			Do not enter m	months		

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2002

POTENTIAL PITFALLS



Remember that
the amount of the
earned income
credit depends on
the taxpayer's
income, number of
qualifying children,
and filing status. Be
sure to use the correct column from the
EIC Table.

Exercise 3

Sam U. and Robin O. Bell are married and file a joint return. Sam's social security number is 000-00-4797 and Robin's is 000-00-4798. They have a child, Jennifer S. Bell (SSN 000-00-1987) who was born in 1996. Jennifer lived with her parents for the entire year. Form 1040, line 7 shows that the Bells had wages of \$21,211, line 8a shows \$39 of taxable interest income, and line 35 shows the Bells' adjusted gross income of \$21,250.

- A. Complete the Form 1040A, line 41 steps, the EIC Worksheet and Schedule EIC.
- B. Report the earned income credit on Form 1040A.

Earned Income (Credit (EIC) Worksheet—Line 41	Keep for Your Records
Part 1 All Filers	1. Enter your earned income from Step 5, on page 43.	
	2. Look up the amount on line 1 above in the EIC Table on pages 46 to find the credit. Be sure you use the correct column for your filin status and the number of children you have. Enter the credit here. If line 2 is zero, You cannot take the credit. Put 'No" to the left of the entry space for line 41.	
	3. Enter the amount from Form 1040A, line 22.	
	 4. Are the amounts on lines 3 and 1 the same? ☐ Yes. Skip line 5; enter the amount from line 2 on line 6. ☐ No. Go to line 5. 	
Part 2 Filers Who Answered 'No" on Line 4	 5. If you have: No qualifying children, is the amount on line 3 less than \$6,150 \$7,150 if married filing jointly)? 1 or more qualifying children, is the amount on line 3 less than (\$14,520 if married filing jointly)? ☐ Yes. Leave line 5 blank; enter the amount from line 2 on line ☐ No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correcolumn for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6. 	\$13,520 6.
Part 3	6. This is your earned income credit.	6 Enter this amount on
Your Earned Income Credit	Reminder— √ If you have a qualifying child, complete and attach Schedule EIC.	Form 1040A, line 41.
	If your EIC for a year after 1996 was reduced or dispage 44 to find out if you must file Form 8862 to tal credit for 2002.	

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

- 1. If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

	Yes.	Continue	•
--	------	----------	---



You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. Continue



You cannot take the credit. Put "No" to the left of the entry space for line 41.

- 41 -

3. Is your filing status married filing separately?

Yes. STOP
You cannot take the credit.

☐ No. Continue **→**

4. Were you a nonresident alien for any part of 2002?

☐ **Yes.** See Nonresident ☐ **No.** Go to Step 2. Aliens on page 44.

5	Step 2 Investment Income							
	Add the amounts from Form 1040A:		Line 8a					
			Line 8b	+				
			Line 9	+				
			Line 10	+				
Investment Income =								
2.	Is your investment income more than \$2,550?							
		es. (STOP)	☐ No.	Ca	ontinue \			

3. Did a child live with you in 2002?

the credit.

☐ **Yes.** Go to Step 3. ☐ **No.** Go to Step 4 on page 42.

(Continued on page 42)

Need more information or forms? See page 9.

Continued from page 41 Step 3 **Qualifying Child** 3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002? A qualifying child is a child who is... Yes. See Qualifying **No.** This child is your Your son, daughter, adopted child, stepchild, or grandchild Child of More Than qualifying child. The child orOne Person on must have a social security page 44. number as defined on page Your brother, sister, stepbrother, or stepsister, or a descendant of 44 unless the child was your brother, sister, etc. (for example, your niece or nephew), born and died in 2002. whom you cared for as your own child Skip Step 4; go to Step 5 on page 43. A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child) Step 4 Filers Without a Qualifying Child If the child was married, see page 42. 1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002? STOP was at the end of 2002... ☐ Yes. No. Continue You cannot take the Under age 19 credit. Put "No" to or the left of the entry space for line 41. Under age 24 and a student (see page 44) 2. Can you, or your spouse if filing a joint return, be claimed or as a dependent on someone else's 2002 tax return? Any age and permanently and totally disabled (see page 44) (STOP Yes. You cannot take the credit. who... 3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002? Lived with you in the United States for more than half ☐ No. (STOP) of 2002. If the child did not live with you for the ☐ Yes. Continue > required time, see Exception to "Time Lived With You" You cannot take the credit. Condition on page 44. Put "No" to the left of the entry space for line 41. Note. If the child was married, see page 44. 4. Was your home, and your spouse's if filing a joint return, in 1. Look at the qualifying child conditions above. Could you, or the United States for more than half of 2002? Members of your spouse if filing a joint return, be a qualifying child of the military stationed outside the United States, see page 44 another person in 2002? before you answer. Yes. (STOP 🔲 No. Continue 🥎 (STOP ☐ **Yes.** Go to Step 5 ∟ No. You cannot take the on page 43. You cannot take the credit. credit. Put "No" to Put "No" to the left of the the left of the entry entry space for line 41. space for line 41. 2. Do you have at least one child who meets the above conditions to be your qualifying child? \square **No.** Skip question 3; go to Step 4, question 2. (Continued on page 41) Need more information or forms? See page 9. - 42 -

Need more information or forms? See page 9.

Exhibit 5 Continued from page 42 Step 6 How To Figure the Credit Step 5 **Earned Income** 1. Figure earned income: 1. Do you want the IRS to figure the credit for you? Form 1040A, line 7 No. Go to the worksheet **Yes.** See Credit Subtract, if included on line 7, any: Figured by the IRS on page 44. below. Taxable scholarship or fellowship grant not reported on a W-2 form Amount paid to an inmate in a **Definitions and Special Rules** penal institution for work (put (listed in alphabetical order) "PRI" and the amount subtracted to the left of the entry space for Adopted Child. Any child placed with you by an line 7 of Form 1040A) authorized placement agency for legal adoption. An • Amount received as a pension or authorized placement agency includes any person authorized annuity from a nonqualified by state law to place children for legal adoption. The deferred compensation plan or a adoption does not have to be final. nongovernmental section 457 plan (put "DFC" and the amount Credit Figured by the IRS. To have the IRS figure the subtracted to the left of the entry space for line 7 of Form 1040A). credit for you: This amount may be shown in box 11 of your W-2 form. If you 1. Put "EIC" to the left of the entry space for line 41 of Form 1040A. received such an amount but box 11 is blank, contact your 2. If you have a qualifying child, complete and attach employer for the amount received Schedule EIC. If your EIC for a year after 1996 was as a pension or annuity. reduced or disallowed, see Form 8862, Who Must File, on page 44. Taxable Earned Income = Go to Step 6. Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if 2. If you have: the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. 2 or more qualifying children, is your earned income less Temporary absences, such as for school, vacation, medical than \$33,178 (\$34,178 if married filing jointly)? care, or detention in a juvenile facility, count as time lived 1 qualifying child, is your earned income less than at home. If your child is presumed to have been kidnapped \$29,201 (\$30,201 if married filing jointly)? by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To • No qualifying children, is your earned income less than get Pub. 596, see page 9. If you were in the military \$11,060 (\$12,060 if married filing jointly)? stationed outside the United States, see Members of the ☐ No. (STOP) Military below. **Yes.** Go to Step 6. You cannot take the credit. Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year: You filed Form 8862 (or other documents) and your EIC was then allowed and Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error. Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud. (Continued on page 44)

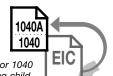
- 43 -

Form 1040A	(2002				Page 2
Tax,	22	Enter the amount from line 21 (adjusted gross income).		22	
credits,			_	_	
and	23a	Check You were 65 or older Blind Enter number of			
payments		if: ☐ Spouse was 65 or older ☐ Blind ☐ boxes checked ▶	23a 🖳	_	
Standard	b	If you are married filing separately and your spouse itemizes		-	1
Deduction		deductions, see page 32 and check here	23b L	1	
for—	24	Enter your standard deduction (see left margin).	0	24	
People who checked any		Subtract line 24 from line 22. If line 24 is more than line 22, enter		25	
box on line 23a or 23b or	26	Multiply \$3,000 by the total number of exemptions claimed on line		26	-
who can be	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter This is your taxable income .	_	0.7	
claimed as a dependent,	28	Tax, including any alternative minimum tax (see page 33).		<u>≻ 27</u> 28	+
see page 33.	29	Credit for child and dependent care expenses.		20	
 All others: Single, 	23	Attach Schedule 2. 29			
\$4,700	30	Credit for the elderly or the disabled. Attach		_	
Head of		Schedule 3. 30			
household, \$6,900	31	Education credits. Attach Form 8863. 31			
Married filing	32	Retirement savings contributions credit. Attach		_	
jointly or Qualifying		Form 8880. 32			
widow(er),	33	Child tax credit (see page 36). 33			
\$7,850 Married	34	Adoption credit. Attach Form 8839. 34			
filing	35	Add lines 29 through 34. These are your total credits.		35	
separately, \$3,925	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0		36	
	37	Advance earned income credit payments from Form(s) W-2.		37	
	38	Add lines 36 and 37. This is your total tax.		▶ 38	
	39	Federal income tax withheld from Forms W-2			
	40	and 1099. 39		_	
If you have	40	2002 estimated tax payments and amount applied from 2001 return. 40			
a qualifying	ــــــ 41	applied from 2001 return. 40 Earned income credit (EIC). 41			
child, attach Schedule	42	Additional child tax credit. Attach Form 8812. 42		_	
EIC.	43	Add lines 39 through 42. These are your total payments.		<u></u>	
Refund	44	If line 43 is more than line 38, subtract line 38 from line 43.		10	
neiuliu		This is the amount you overpaid.		44	
Direct	45a	Amount of line 44 you want refunded to you.	•	► 45a	
deposit? See page 47	▶ b	Routing Observing Observing Observing	•		
and fill in		number	ings		
45b, 45c, and 45d.	▶ d	Account			
and rod.		number		_	
	46	Amount of line 44 you want applied to your			
<u> </u>	47	2003 estimated tax. 46			1
Amount	47	Amount you owe. Subtract line 43 from line 38. For details on ho to pay, see page 48.		→ 47	
you owe	48	Estimated tax penalty (see page 48). 48		41	
		Do you want to allow another person to discuss this return with the IRS (see page 45)	9)? Yes	. Complete the following	na. \square No
Third party		Designee's Phone	-	dentification	of my ration e number
designee		resignee's Priorie name ► no. ► ()	number (P		
Sign		Inder penalties of perjury, I declare that I have examined this return and accompanying schedule nowledge and belief, they are true, correct, and accurately list all amounts and sources of income I			
here	C	of preparer (other than the taxpayer) is based on all information of which the preparer has any kr		9	
Joint return?	\ '	our signature Date Your occupation		Daytime phone nur	nber
See page 20. Keep a copy	b -			()	
for your		Spouse's signature. If a joint return, both must sign. Date Spouse's occupation			
records.	,	Data		Propororio CCN or DT	//////////////////////////////////////
Paid		Preparer's Date Chec	ck if employed	Preparer's SSN or PT	IIN
preparer's	_	irm's name (or	EIN	<u> </u>	
use only	У	ours if self-employed), ddress, and ZIP code	Phone no.	()	
		₩	1101	Form 1040	A (2002)
		\ *\			- (-30-)

SCHEDULE EIC (Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

2002

Attachment Sequence No. 43

Department of the Treasury
Internal Revenue Service (99
Name(s) shown on return

Complete and attach to Form 1040A or 1040 only if you have a qualifying child.

Your social security number

Schedule EIC (Form 1040A or 1040) 2002

Before you begin:

See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
 It will take us longer to process your return and issue your refund if you do not fill in all lines that apply
- for each qualifying child.
 Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Q	ualifying Child Information	C	hild 1	C	nild 2
1	Child's name If you have more than two qualifying children, you only have to list two to get the maximum credit.	First name	Last name	First name	Last name
2	Child's SSN The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.				
3	Child's year of birth	Year If born after 19 and 4b; go to l	 183, skip lines 4a ine 5.	Year If born after 19 and 4b; go to li	83, skip lines 4a ne 5.
-	If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student?	Yes. Go to line 5.	No. Continue	Yes. Go to line 5.	No. Continue
k	Was the child permanently and totally disabled during any part of 2002?	Yes.	No. The child is not a qualifying child.	Yes. Continue	No. The child is not a qualifying child.
5	Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)				
6	Number of months child lived with you in the United States during 2002				
	• If the child lived with you for more than half of 2002 but less than 7 months, enter "7".				are a the
	 If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	Do not enter m	months ore than 12 months.	Do not enter m	months ore than 12 months.

Cat. No. 13339M

10-18

or 1040 instructions.

Lesson 10

For Paperwork Reduction Act Notice, see Form 1040A

Advance Earned Income Credit Payments

An employee who expects to qualify for the earned income credit (EIC) and to have at least one qualifying child for 2003 can choose to get a portion of the credit in advance throughout the year (based on one qualifying child) by giving a filled out Form W-5, *Earned Income Credit Advance Payment Certificate*, to his or her employer. Taxpayers receive only a portion of the credit through advance payments, so the eligibility questions and the EIC Worksheet must be completed when the tax return is prepared to determine the full amount of the credit the taxpayer is entitled to receive.

If the employee chooses to receive the EIC in advance, the employer will include advance payments of the credit in the employee's regular paychecks during the year. Employees who receive advance earned income credit payments *must* file a tax return even if they are not otherwise required to file.

Advance earned income credit payments are reported in box 9 of Form W-2. Enter this amount on Form 1040A, line 37, or Form 1040, line 59.

Exercise 4

Kyle B. Evans is a single parent. He claims his daughter, Julie, as a dependent on his tax return. Kyle's social security number is 000-00-2442. Julie was born in November 2001. Her social security number is 000-00-4104. Kyle's earned income was \$18,751, and his total income and adjusted gross income were \$19,223. He received \$550 in advance earned income credit payments.

- **A.** Complete Kyle's eligibility questions and EIC Worksheet.
- **B.** What entries would you make on Schedule EIC?

TAX TIPS ******* Advance earned income credit payments are based on the taxpayer's wages for the payroll period. Only

persons who expect to have at least one qualifying child can get the advance EIC payment.

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

- **1.** If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes.	Continue	7



You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?





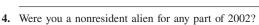
You cannot take the credit. Put "No" to the left of the entry space for line 41.

- 41 -

3. Is your filing status married filing separately?



☐ No. Continue



☐ **Yes.** See Nonresident ☐ **No.** Go to Step 2. Aliens on page 44.

Step 2 Investment Income

1. Add the amounts from Form 1040A:

Line 8a

Line 8b + _____

Line 10 +

Investment Income =

2. Is your investment income more than \$2,550?

Yes. STOP	
You cannot take	e
the credit.	

☐ No. Continue →



3. Did a child live with you in 2002?

Yes.	Go	to	Step	3

No. Go to Step 4 on page 42.

(Continued on page 42)

Need more information or forms? See page 9.

Continued from page 41 Step 3 **Qualifying Child** 3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002? A qualifying child is a child who is... ☐ **Yes.** See Qualifying No. This child is your Your son, daughter, adopted child, stepchild, or grandchild Child of More Than qualifying child. The child One Person on must have a social security page 44. number as defined on page Your brother, sister, stepbrother, or stepsister, or a descendant of 44 unless the child was your brother, sister, etc. (for example, your niece or nephew), born and died in 2002. whom you cared for as your own child Skip Step 4; go to Step 5 on page 43. A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child) Step 4 Filers Without a Qualifying Child If the child was married, see page 42. 1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002? Yes. (STOP) was at the end of 2002... 🔲 No. Continue 🥆 You cannot take the Under age 19 credit. Put "No" to \mathbf{or} the left of the entry space for line 41. Under age 24 and a student (see page 44) 2. Can you, or your spouse if filing a joint return, be claimed or as a dependent on someone else's 2002 tax return? Any age and permanently and totally disabled (see page 44) (STOP Yes. ☐ No. Continue > You cannot take the credit. 3. Were you, or your spouse if filing a joint return, at least age who... 25 but under age 65 at the end of 2002? Lived with you in the United States for more than half ⊔ No. ^(sтор) of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" You cannot take the credit. Condition on page 44. Put "No" to the left of the entry space for line 41. Note. If the child was married, see page 44. 4. Was your home, and your spouse's if filing a joint return, in 1. Look at the qualifying child conditions above. Could you, or the United States for more than half of 2002? Members of your spouse if filing a joint return, be a qualifying child of the military stationed outside the United States, see page 44 another person in 2002? before you answer. STOP Yes. 🗌 No. Continue 🥎 \square **Yes.** Go to Step 5 You cannot take the You cannot take the credit. on page 43. credit. Put "No" to Put "No" to the left of the the left of the entry entry space for line 41. space for line 41. 2. Do you have at least one child who meets the above conditions to be your qualifying child? 🗌 **Yes.** Continue 🔁 \square **No.** Skip question 3; go to Step 4, question 2. (Continued on page 41) Need more information or forms? See page 9. - 42 -

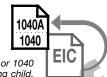
Continued from page 42	
Step 5 Earned Income	Step 6 How To Figure the Credit
1. Figure earned income:	1. Do you want the IRS to figure the credit for you?
Form 1040A, line 7	☐ Yes. See Credit ☐ No. Go to the worksheet
Subtract, if included on line 7, any:	Figured by the IRS on page 44.
• Taxable scholarship or fellowship grant not reported on a W-2 form	below.
 Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A) Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 	Definitions and Special Rules (listed in alphabetical order) Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.
plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity. Taxable Earned Income =	Credit Figured by the IRS. To have the IRS figure the credit for you: 1. Put "EIC" to the left of the entry space for line 41 of Form 1040A. 2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.
 Go to Step 6. 2. If you have: 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)? 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)? No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)? Yes. Go to Step 6. No. STOP 	Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.
You cannot take the credit.	Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year: • You filed Form 8862 (or other documents) and your EIC was then allowed and • Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error. Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

Earned Income (Credit (EIC) Worksheet—Line 41 Kee	p for Your Records
Part 1 All Filers	 Enter your earned income from Step 5, on page 43. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41. Enter the amount from Form 1040A, line 22. Are the amounts on lines 3 and 1 the same? Yes. Skip line 5; enter the amount from line 2 on line 6. No. Go to line 5. 	
Part 2 Filers Who Answered "No" on Line 4	 5. If you have: No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? 1 or more qualifying children, is the amount on line 3 less than \$13,52 (\$14,520 if married filing jointly)? Yes. Leave line 5 blank; enter the amount from line 2 on line 6. No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6. 	5
Part 3 Your Earned Income Credit	6. This is your earned income credit. **Reminder** If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed page 44 to find out if you must file Form 8862 to take the credit for 2002.	Enter this amount on Form 1040A, line 41.

SCHEDULE EIC (Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

2002

Attachment Sequence No. 43

Department of the Treasury Internal Revenue Service (99 Name(s) shown on return Complete and attach to Form 1040A or 1040 only if you have a qualifying child.

Your social security number

Before you begin:

See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Child's name f you have more than two qualifying children, you	First name	Last many		
only have to list two to get the maximum credit.		Last name	First name	Last name
Child's SSN The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.				
Child's year of birth				
If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student?	Yes.	No. S. Continue	Yes. Go to line 5.	No. Continue
Was the child permanently and totally disabled during any part of 2002?	Yes.	No. The child is not a qualifying child.	Yes. Continue	No. The child is not a qualifying child.
Child's relationship to you for example, son, daughter, grandchild, coster child, etc.)				
Number of months child lived with you in the United States during 2002				
 If the child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	Do not ente	months	Do not enter m	months ore than 12 months.
	form 1040 instructions unless the child was born and ied in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate. Child's year of birth If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student? Was the child permanently and totally disabled during any part of 2002? Child's relationship to you for example, son, daughter, grandchild, oster child, etc.) Sumber of months child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". You may also be able to take the additional contents and the contents and the contents are child.	form 1040 instructions unless the child was born and ied in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate. Child's year of birth Year If born after and 4b; go If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student? Was the child permanently and totally disabled during any part of 2002? Child's relationship to you for example, son, daughter, grandchild, oster child, etc.) Sumber of months child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". You may also be able to take the additional child tax of the child tax of t	form 1040 instructions unless the child was born and lied in 2002. If your child was born and died in 2002. If your child was born and died in 2002 in did did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate. Child's year of birth Year	form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 in the child lived with you for example, son, daughter, grandchild, oster child, etc.) Was the child lived with you for more than half of 2002 bif the child lived with you for example, son, daughter, grandchild, oster child, etc.) Was the child lived with you for more than half of 2002 bif the child lived with you for more than half of 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". Year Year Year If born after 1983, skip lines 4a and 4b; go to line 5. Year Year If born after 1983, skip lines 4a and 4b; go to line 5. Year Year If born after 1983, skip lines 4a and 4b; go to line 5. Year Year If born after 1983, skip lines 4a and 4b; go to line 5. Year Year If born after 1983, skip lines 4a and 4b; go to line 5. Wear Year If born after 1983, skip lines 4a and 4b; go to line 5. Wear Year If born after 1983, skip lines 4a and 4b; go to line 5. Wear Year If born after 1983, skip lines 4a and 4b; go to line 5. Continue

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2002

EARNED INCOME CREDIT Answers to Exercises

Lesson 10

Exercise 1

- (A) No; to be a qualifying child, the child must live with the tax-payer more than half of the year.
- (B) Neither Donna nor Doug can claim the credit; in order to claim the earned income credit, married taxpayers living together must file a joint return.
- (C) Jimmy and Anna are qualifying children of both Randy and Cara. Randy and Cara can choose which of them will claim the credit based on each child. One can claim the credit on the basis of two children, or each can claim the credit on the basis of one child. If both claim the credit on the basis of the same child or both children, Cara will be entitled to the credit because each child lived with her for the longer period of time during the year.
- (D) Yes. He is between 25 and 65; his earned income is less than \$11,060; he cannot be claimed as a dependent and he is not a qualifying child of another person.
- (E) No; to be a qualifying child, a married child must generally be eligible to be claimed as a dependent by the taxpayer.
- (F) Numbers 1 and 6 should be circled.

Exercise 2

- (A) \$3,012
- (B) \$1,826

EARNED INCOME CREDIT Answers to Exercises

Exercise 3 Bell's EIC Worksheet

Part 1	1. Enter your earned income from Step 5, on	
All Filers	page 43.	
	2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41.	1,434
	3. Enter the amount from Form 1040A, line 22. 3 21,250	
	4. Are the amounts on lines 3 and 1 the same?	
	\square Yes. Skip line 5; enter the amount from line 2 on line 6.	
	□ No. Go to line 5.	
Part 2 Filers Who Answered "No" on Line 4	 If you have: No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)? Yes. Leave line 5 blank; enter the amount from line 2 on line 6. No. Look up the amount on line 3 in the EIC Table on pages 46-51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6. 	5 1,426
Part 3	6. This is your earned income credit.	6 1,426
Your Earned Income Credit	Reminder— √ If you have a qualifying child, complete and attach Schedule EIC.	Enter this amount on Form 1040A, line 41.
	If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.	_ 9

Lesson 10

Exercise 3

Bell's Eligibility Questions, page 1

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1

All Filers

- 1. If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

X	Yes.	Continue	2
			4



You cannot take the credit.

- 2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?
 - X Yes. Continue



You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Is your filing status married filing separately?

Yes. (STOP) You cannot take the credit.





4. Were you a nonresident alien for any part of 2002?

 \square **Yes.** See Nonresident \boxtimes **No.** Go to Step 2. Aliens on page 44.

Step 2 **Investment Income**

1. Add the amounts from Form 1040A:

\$39 Line 8a 0 Line 8b + 0 Line 9 0 Line 10 +

Investment Income =

\$39

2. Is your investment income more than \$2,550?

[STOP] Yes. You cannot take the credit.

X No. Continue



3. Did a child live with you in 2002?

X Yes. Go to Step 3. \square No. Go to Step 4 on

page 42.

(Continued on page 42)

Lesson 10

EARNED INCOME CREDIT Answers to Exercises

Exercise 3

Bell's Eligibility Questions, page 2

Continued from page 41 Step 3 **Qualifying Child** 3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002? A qualifying child is a child who is... ☐ **Yes.** See Qualifying X No. This child is your Your son, daughter, adopted child, stepchild, or grandchild qualifying child. The child Child of More Than or One Person on must have a social security number as defined on page page 44. Your brother, sister, stepbrother, or stepsister, or a descendant of 44 unless the child was your brother, sister, etc. (for example, your niece or nephew), born and died in 2002. whom you cared for as your own child Skip Step 4; go to Step 5 on page 43. A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child) Step 4 Filers Without a Qualifying Child If the child was married, see page 42. 1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002? STOP was at the end of 2002... __ Yes. 🔲 No. Continue 🦒 You cannot take the Under age 19 credit. Put "No" to the left of the entry space for line 41. Under age 24 and a student (see page 44) 2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return? Any age and permanently and totally disabled (see page 44) STOP Yes. ☐ No. Continue You cannot take the credit. 3. Were you, or your spouse if filing a joint return, at least age who... 25 but under age 65 at the end of 2002? Lived with you in the United States for more than half \square No. $^{ ext{(STOP)}}$ of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" You cannot take the credit. Condition on page 44. Put "No" to the left of the entry space for line 41. Note. If the child was married, see page 44. 4. Was your home, and your spouse's if filing a joint return, in 1. Look at the qualifying child conditions above. Could you, or the United States for more than half of 2002? Members of your spouse if filing a joint return, be a qualifying child of the military stationed outside the United States, see page 44 another person in 2002? before you answer. (STOP) Yes. X No. Continue ☐ No. (STOP) Yes. Go to Step 5 You cannot take the on page 43. You cannot take the credit. credit. Put "No" to Put "No" to the left of the the left of the entry entry space for line 41. space for line 41. 2. Do you have at least one child who meets the above conditions to be your qualifying child? X Yes. Continue No. Skip question 3; go to Step 4, question 2. (Continued on page 41)

EARNED INCOME CREDIT Answers to Exercises

Lesson 10

Exercise 3

Bell's Eligibility Questions, page 3

Continued from page 42	T.
Step 5 Earned Income	Step 6 How To Figure the Credit
. Figure earned income:	1. Do you want the IRS to figure the credit for you?
Form 1040A, line 7 21,211	Yes. See Credit X No. Go to the worksheet
Subtract, if included on line 7, any:	Figured by the IRS on page 44.
 Taxable scholarship or fellowship grant not reported on a W-2 form 	below.
 Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A) Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity. 	Definitions and Special Rules (listed in alphabetical order) Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final. Credit Figured by the IRS. To have the IRS figure the credit for you: 1. Put "EIC" to the left of the entry space for line 41 of Form 1040A. 2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File on page 44.
If you have: • 2 or more qualifying children, is your earned income less	Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002
 than \$33,178 (\$34,178 if married filing jointly)? 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)? No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)? 	Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.
You cannot take the credit.	Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:
	 You filed Form 8862 (or other documents) and your EIC was then allowed and
	 Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
	Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentiona disregard of the EIC rules or fraud.
	(Continued on page 4-

Lesson 10

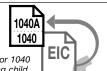
EARNED INCOME CREDIT Answers to Exercises

Exercise 3 The Bell's Schedule EIC

SCHEDULE EIC (Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

Department of the Treasury Internal Revenue Service (99)

Complete and attach to Form 1040A or 1040 only if you have a qualifying child.

Attachment Sequence No. **43**

Name(s) shown on return

Sam U. and Robin O. Bell

Your social security number 000 00 4797

Before you begin:

See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.

- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.
 Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Qualifying Child Information		Child 1	Cł	nild 2
1 Child's name If you have more than two qualifying children, you only have to list two to get the maximum credit.	First name Jenn	Last name	First name	Last name
The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.	2	00 1987		
3 Child's year of birth		9 9 6 r 1983, skip lines 4a to line 5.	Year If born after 198 and 4b; go to lii	
If the child was born before 1984— a Was the child under age 24 at the end of 2002 and a student?	Yes.	No. Continue	Yes. Go to line 5.	No.
b Was the child permanently and totally disabled during any part of 2002?	Yes.	No. The child is not a qualifying child.	Yes. Continue	No. The child is not a qualifying child.
Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)	d	laughter		
Number of months child lived with you in the United States during 2002				
 If the child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	Do not ente	12 months	Do not enter mo	months
You may also be able to take the ad claimed as your dependent on line of details, see the instructions for line	oc of Form 1040A	or Form 1040, and (c) is a		
For Paperwork Reduction Act Notice, see Form 104	0A C	at. No. 13339M	Schedule EIC (Form	n 1040A or 1040) 200

10-30

Lesson 10

or 1040 instructions.

EARNED INCOME CREDIT Answers to Exercises

Lesson 10

Exercise 3 Bell's Form 1040A, page 2

dependent, see page 33.	28	Tax, including any alternative minimum tax (see page 33).	28	
All others:	29	Credit for child and dependent care expenses.		
Single,		Attach Schedule 2. 29	_	
\$4,700 Head of	30	Credit for the elderly or the disabled. Attach		
household,		Schedule 3.	_	
\$6,900	31	Education credits. Attach Form 8863.		
Married filing jointly or	32	Retirement savings contributions credit. Attach		
Qualifying		Form 8880. 32		
widow(er), \$7,850	33	Child tax credit (see page 36).	<u> </u>	
Married	34	Adoption credit. Attach Form 8839. 34		
filing	35	Add lines 29 through 34. These are your total credits.	35	
separately, \$3,925	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0	36	
(ψο,οΣο	37	Advance earned income credit payments from Form(s) W-2.	37	
	38	Add lines 36 and 37. This is your total tax.	▶ 38	
	39	Federal income tax withheld from Forms W-2		
		and 1099. 39		
	40	2002 estimated tax payments and amount		
If you have		applied from 2001 return. 40		
a qualifying child, attach	້ 41	Earned income credit (EIC). 41 1,426 00)	
Schedule	42	Additional child tax credit. Attach Form 8812. 42		
EIC.	43	Add lines 39 through 42. These are your total payments.	- 43	

Exercise 4

- (A) See Kyle's completed steps and the EIC worksheet.
- (B) See Kyle's Schedule EIC.

Lesson 10

EARNED INCOME CREDIT Answers to Exercises

Exercise 4 (D)

Kyle's EIC Eligibility Questions, page 1

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



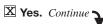
If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1

All Filers

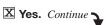
- 1. If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?





You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?





You cannot take the credit.

Put "No" to the left of the entry space for line 41.

3. Is your filing status married filing separately?

Yes. STOP
You cannot take

X No. Continue

the credit.

4. Were you a nonresident alien for any part of 2002?

Yes. See Nonresident Aliens on page 44.

🗵 No.	Go	to S	tep	2
-------	----	------	-----	---

Step 2 Investment Income

1. Add the amounts from Form 1040A:

Line 8a

Line 8b + 0

Line 9 + 0

Line 10 + O

2. Is your investment income more than \$2,550?

Yes. STOP
You cannot take the credit.

X No. Continue



3. Did a child live with you in 2002?

lacksquare Yes. Go to Step 3.

No. Go to Step 4 on page 42.

(Continued on page 42)

Lesson 10

EARNED INCOME CREDIT Answers to Exercises

Exercise 4 (D)

Kyle's EIC Eligibility Questions, page 2

Continued from page 41	Kyle's ETC Eligibility Questions, pag
Step 3 Qualifying Child A qualifying child is a child who is	3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?
Your son, daughter, adopted child, stepchild, or grandchild or Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child or	☐ Yes. See Qualifying Child of More Than One Person on page 44. No. This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. Skip Step 4; go to Step 5 on page 43.
A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child) If the child was married, see page 42.	Step 4 Filers Without a Qualifying Child
AND	1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?
was at the end of 2002 Under age 19 or Under age 24 and a student (see page 44)	Yes. STOP You cannot take the credit. Put "No" to the left of the entry space for line 41.
Any age and permanently and totally disabled (see page 44) AND	2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return? Yes. No. Continue You cannot take the credit.
who Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44. Note. If the child was married, see page 44.	3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002? Yes. Continue You cannot take the credit. Put "No" to the left of the entry space for line 41.
1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?	4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.
Yes. Stop You cannot take the credit. Put "No" to the left of the entry space for line 41.	Yes. Go to Step 5 on page 43. No. Stop You cannot take the credit. Put "No" to the left of the entry space for line 41.
2. Do you have at least one child who meets the above conditions to be your qualifying child? X Yes. Continue No. Skip question 3; go to	
	(Continued on page 4.

EARNED INCOME CREDIT Answers to Exercises

Lesson 10

Exercise 4 (D)

Kyle's EIC Eligibility Questions, page 3

Continued from page 42	
Step 5 Earned Income	Step 6 How To Figure the Credit
1. Figure earned income:	1. Do you want the IRS to figure the credit for you?
Form 1040A, line 718,751	☐ Yes. See Credit
Subtract, if included on line 7, any:	Figured by the IRS on page 44.
• Taxable scholarship or fellowship grant not reported on a W-2 form	Delow.
 Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for 	Definitions and Special Rules (listed in alphabetical order)
line 7 of Form 1040Å)	Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An
Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457	authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.
plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in	Credit Figured by the IRS. To have the IRS figure the credit for you:
box 11 of your W-2 form. If you received such an amount but box	1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
11 is blank, contact your employer for the amount received as a pension or annuity.	2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File
Taxable Earned Income = 18,751	on page 44.
Go to Step 6.	Exception to "Time Lived With You" Condition. A
2. If you have:	child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this
• 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?	child's home for the entire time he or she was alive in 2002 Temporary absences, such as for school, vacation, medical
• 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?	care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to
• No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?	find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military
X Yes. Go to Step 6. \Bigcup No. Stop You cannot take the credit.	stationed outside the United States, see Members of the Military below.
Tou cannot take the credit.	Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do no file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:
	You filed Form 8862 (or other documents) and your EIC was then allowed and
	 Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
	Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the FIC rules or fraud.

(Continued on page 44)

EARNED INCOME CREDIT Answers to Exercises

Exercise 4 (D) Kyle's EIC Worksheet

Earned Income (Credit (EIC) Worksheet—Line 41 Keep for Your Records
Part 1 All Filers	 Enter your earned income from Step 5, on page 43. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. If line 2 is zero, Put "No" to the left of the entry space for line 41. Enter the amount from Form 1040A, line 22.
	4. Are the amounts on lines 3 and 1 the same? ☐ Yes. Skip line 5; enter the amount from line 2 on line 6. ☒ No. Go to line 5.
Part 2 Filers Who Answered "No" on Line 4	 5. If you have: No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)? ☐ Yes. Leave line 5 blank; enter the amount from line 2 on line 6. ☒ No. Look up the amount on line 3 in the EIC Table on pages 46-51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6.
Part 3 Your Earned Income Credit	6. This is your earned income credit. Reminder— If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

Earned Income Credit Answers to Exercises

Lesson 10

Exercise 4 (E) Kyle's Form 1040A, page 2

SCHEDULE EIC (Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

Department of the Treasury Internal Revenue Service

Name(s) shown on return Kyle B. Evans

Your social security number 000 00 2442

Before you begin:

See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

ie Eva. 000 00 2 0 orn after 1983, 4b; go to line Yes. to line 5.	4104 <u>0</u> <u>1</u> , skip lines 4a	Year	2 5. No.
2 0 orn after 1983, 4b; go to line	O 1	If born after 1983 and 4b; go to line Yes.	2 5. No.
orn after 1983, 4b; go to line	skip lines 4a 5. No.	If born after 1983 and 4b; go to line Yes.	2 5. 1 No.
			— ·····
		Go w ane 5.	Continue
Yes.	No. The child is not a qualifying child.	Yes. Continue	No. The child is not a qualifying child.
- 1 -			
]	12 manths		months
Do not enter more than 12 month		Do not enter mor	
ni	daught	The child is not a qualifying child. daughter 12 months not enter more than 12 months.	The child is not a qualifying child. Continue daughter

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2002

or 1040 instructions.

For Paperwork Reduction Act Notice, see Form 1040A

▶ SUMMING UP THIS LESSON ◀◀

- The earned income credit can be claimed on Form 1040EZ, Form 1040A or Form 1040.
- Significant rules and qualifications for earned income credit were implemented beginning in January, 2002. They are:
 - 1. New definition for earned income.
 - 2. Elimination of modified adjusted gross income now just adjusted gross income.
 - 3. New definition for foster child.
 - 4. New rules when more than one taxpayer has the same qualifying child.

		ENT NOTES
	STUD	ENT NOTES
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CHILD TAX CREDIT

Lesson 11

Introduction and Objectives

In this lesson you will learn about the child tax credit. This credit is unique because it can be both nonrefundable and refundable. This lesson will discuss who qualifies for the credit and how to calculate the credit.

After completing this lesson you should be able to:

- Calculate the child tax credit using the child tax credit worksheet.
- Calculate the additional child tax credit by using form 8812.

TAX TIPS

***** If the taxpayer can claim the child tax credit on his or her income tax return, the taxpayer may want to consider having less tax withheld from his or her wages during the year. To check his or her withholding allowances for 2003, the taxpaver should fill out a 2003 Form W-4. If the taxpaver can claim more withholding allowances, he or she should file a new Form W-4 with his or her employer so that less income tax is withheld from his or her wages (See Lesson 7, Finishing the Return).

CHILD TAX CREDIT

A taxpayer can claim a child tax credit for each of the taxpayer's qualifying children. The maximum child tax credit is \$600 per child for 2002. The credit can be claimed on either Form 1040 or 1040A.

Qualifying child

To qualify, the child must be:

- Under age 17 at the end of 2002,
- A citizen or resident of the United States,
- The taxpayer's dependent, and
- The taxpayer's:

Son or daughter,

Stepson or stepdaughter, adopted child,

Grandchild, or

Eligible foster child

The taxpayer must provide the name and identification number (usually a social security number) of each qualifying child on his or her tax return.

Limits on credit

The amount of a taxpayer's child tax credit depends on the taxpayer's modified adjusted gross income (modified AGI) and the taxpayer's filing status.

Modified AGI

The credit begins to phase out if the taxpayer's modified AGI is above a certain amount (**Table 1**). For most taxpayers, modified AGI is generally the same as AGI. For 2002, AGI is shown on line 22 of Form 1040A and on line 36 of Form 1040.

Table 1: Child Tax Credit Threshold Modified AGI Amounts for **Claiming Child Tax Credit**

Filing Status	Amount	
Married filing jointly	\$110,000	
Qualifying widow(er)	75,000	
Head of household	75,000	
Single	75,000	
Married filing separately	55,000	

Before you can figure a taxpayer's credit amount for the year. you must have the taxpayer answer certain questions (Exhibit 1) to see if you must use the worksheet in Publication 972, *Child Tax Credit.* These questions are in the tax form instructions. If you do not need to use Publication 972, you can use the shorter Child Tax Credit Worksheet in the form instructions.

Example 1

Bill and Mary Allen have two dependent children under age 17. The children are qualifying children for purposes of claiming the child tax credit. Bill and Mary have modified AGI of \$34,000. Bill and Mary need to answer questions to determine if they must use Publication 972 (Exhibit 1). The completed Child Tax Credit Worksheet (Exhibit 2) shows that their credit is \$1.200. Their modified AGI is less than the phaseout amount for their filing status (\$110,000), so they are entitled to the full credit.

TAX TIPS ***** If the taxpayer's modified adjusted gross income exceeds the threshold limit, the taxpaver must use **Publication 972 to** compute his or her

child tax credit.

TAX TIPS ***** A copy of a Child **Tax Credit** Worksheet can be found in the *Tax* Forms Booklet Appendix, which is part of your **Publication 678** Package.

WAGE EARNER

Exhibit 1 Bill and Mary Allen

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- **Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- **Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- **Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



- 1. Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly -\$110,000
 - Single, head of household, or qualifying widow(er) \$75,000
 - Married filing separately -\$55,000

x No.	Continue
-------	----------

/ \
STOP

You must use Pub. 972 to figure your credit.

- **2.** Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
 - **No.** Use the worksheet on page 39 to figure your child tax credit.

Yes. You must use
Pub. 972 to figure your
child tax credit. You will
also need Form 8839.

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered "Yes" to question 1 or 2 on page 38. Instead, use Pub. 972.



			_			
1.	Number of qual	ifying children:	× \$	600. Enter the result.	1	1,200
					_	
2.	Enter the amour	nt from Form 1040A,	, line 28.	2 1,58	26	
3.	Add the amount	s from Form 1040A:				
	Line 29	0				
	Line 30 + _	0				
	Line 31 + _	0				
	Line 32 + _	0	Enter the total.	3	0	
	to reduce. He completing the	ake this credit because owever, see the TIP be he rest of your Form t line 3 from line 2.	elow before		4	1,526
5.	Is the amount of	n line 1 more than th	ne amount on line	4?		
	Yes. Enter the amount from line 4. Also, see the TIP below. This is your child tax credit.				5	1,200
	X No. Enter th	e amount from line			Enter this of Form 1040.	amount on
	You	u may be able to ta	ake the addition	al child tax credit	1040	→ :
		Form 1040A, line				



or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

TAX TIPS

Taxpayers who can claim the additional child tax credit should file a tax return even if they are not otherwise required to file because the additional child tax credit may give the taxpayer a refund even if he or she does not owe any tax.

TAX TIPS

The child tax credit
must be figured,
before the additional child tax
credit can be figured.

Additional Child Tax Credit

The child tax credit is a nonrefundable credit that gives eligible taxpayers \$600 for each qualifying child. If a taxpayer's tax liability is less than the allowable nonrefundable child tax credit, the taxpayer may be eligible to claim the **refundable additional child tax credit**.

Beginning in 2001, the additional child tax credit was expanded to include **all** taxpayers who have *earned income* regardless of the number of qualifying children. This extended the refundable part of the child tax credit to families who have less than three qualified children.

Before figuring additional child tax credit, figure the taxpayer's:

- Unused nonrefundable child tax credit amount,
- Total Social Security and Medicare taxes withheld (Form W-2, *Wage and Tax Statement*, boxes 4 and 6),
- Earned income credit amount,
- Total taxable earned income (back of Form 8812), and
- For 1040 filers, one-half of self-employment tax paid, Form 1040, line 29.

The taxpayer will need to seek the assistance of a paid professional tax preparer if he or she has:

- Excess social security and RRTA tax withheld (more than one employer and gross income in excess of \$84,900) or
- Social Security and Medicare tax on *unreported* tip income.

Taxpayers must use **Form 8812,** *Additional Child Tax Credit*, to claim the additional child tax credit. This credit is based on 10% of the taxpayer's taxable earned income in excess of \$10.350.

Form 8812 explains step-by-step how to compute the additional child tax credit. The form allows a taxpayer who can use both rules to claim the larger additional child tax credit. That is, taxpayers with three or more children can continue to claim a refundable additional tax credit, under the rules that applied in prior years, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of \$10,350.

Example 2

Maureen Langston is filing Form 1040A. Her filing status is head of household for 2002. She has five dependent children, all of whom are qualifying children for purposes of the child tax credit. Maureen's earned income (and adjusted gross income) is \$26,375, her tax is \$149, Social Security/Medicare taxes are \$2,018, and the earned income credit is \$1,433. Based on this information, Maureen's child tax credit is \$149 (Exhibit 4) and her additional child tax credit is \$1,603. Exhibits 5 and 6 illustrate how Maureen's additional child tax credit was figured.

POTENTIAL PITFALLS



When figuring the additional child tax credit, you *must* use the back of Form 8812 to determine taxable earned income (line 4).

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- **Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- **Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- **Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



- 1. Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly -\$110,000
 - Single, head of household, or qualifying widow(er) \$75,000
 - Married filing separately -\$55,000

X No. Continue



You must use Pub. 972 to figure your credit.

- **2.** Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
 - Wo. Use the worksheet on page 39 to figure your child tax credit.

Yes. You must use
Pub. 972 to figure your
child tax credit. You will
also need Form 8839.

Child Tax Credit Wo	rksheet—Line 33	Keep for Your Records
Do not use this Instead, use Pu	worksheet if you answered "Yes" to question 1 or 2 on page 38. b. 972.	<i>#</i> /
1.	Number of qualifying children: 5 × \$600. Enter the result.	1 3,000
2.	Enter the amount from Form 1040A, line 28.	9
3.	Add the amounts from Form 1040A: Line 29	0
4.	Are the amounts on lines 2 and 3 the same? Yes. STOP You cannot take this credit because there is no tax to reduce. However, see the TIP below before completing the rest of your Form 1040A. No. Subtract line 3 from line 2.	4 149
5.	Is the amount on line 1 more than the amount on line 4?	Enter this amount on Form 1040A, line 33.
	You may be able to take the additional child tax credit on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above. • First, complete your Form 1040A through line 41. • Then, use Form 8812 to figure any additional child tax credit.	1040A

OMB No. 1545-1620 **Additional Child Tax Credit** 1040A Department of the Treasury Sequence No. 47 Complete and attach to Form 1040 or Form 1040A. Internal Revenue Service Name(s) shown on return Your social security number Maureen Langston 000 00 9999 Part I **All Filers** Enter the amount from line 1 of your Child Tax Credit Worksheet on page 38 of the Form 1040 instructions or page 37 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 8 of the 3,000 00 worksheet on page 3 of the publication 149 00 Enter the amount from Form 1040, line 50, or Form 1040A, line 33 2,,851 00 Subtract line 2 from line 1. If zero, stop; you cannot take this credit Enter your total taxable earned income. See the instructions on back Is the amount on line 4 more than \$10,350? **No.** Leave line 5 blank and enter -0- on line 6. 16,025 00 Yes. Subtract \$10,350 from the amount on line 4. Enter the result Multiply the amount on line 5 by 10% (.10) and enter the result Next. Do you have three or more qualifying children? No. If line 6 is zero, stop; you cannot take this credit. Otherwise, skip Part II and enter the smaller of line 3 or line 6 on line 13. X Yes. If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7. Part II Certain Filers Who Have Three or More Qualifying Children Enter the total of the withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts 7 2,018 00 with yours. If you worked for a railroad, see the instructions on back . . . Enter the total of the amounts from Form 1040, lines 29 and 57, plus any uncollected social security and 8 0 00 Medicare or tier 1 RRTA taxes included on line 61. 1040A filers: Enter -0-2,018 00 Add lines 7 and 8 10 **1040 filers:** Enter the total of the amounts from Form 1040, lines 64 and 65. 1040A filers: Enter the total of the amount from Form 1040A, line 1,433 00 10 41, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 43 (see the instructions on back). 11 585 00 Subtract line 10 from line 9. If zero or less, enter -0- . . . 11 12 1,602 50 12 Enter the **larger** of line 6 or line 11 here Next, enter the smaller of line 3 or line 12 on line 13. Your Additional Child Tax Credit Part III 1,602 50 This is your additional child tax credit Enter this amount on Form 1040, line 66, or Form 1040A, line 42. For Paperwork Reduction Act Notice, see back of form. Form 8812 (2002) Cat. No. 10644E

Form 8812 (2002) Page 2

Instructions

Purpose of Form

Use Form 8812 to figure your additional child tax credit.



The additional child tax credit may give you a refund even if you do not owe any tax.

Who Should Use Form 8812

First, complete the Child Tax Credit Worksheet that applies to you. See the instructions for Form 1040, line 50, or Form 1040A, line 33. If you meet the condition given in the **TIP** at the end of your Child Tax Credit Worksheet, use Form 8812 to see if you can take the additional child tax credit.

Effect of Credit on Welfare Benefits

Any refund you receive as a result of taking the additional child tax credit will not be used to determine if you are eligible for the following programs, or how much you can receive from them.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

Taxable Earned Income

1. Did you, or your spouse if filing a joint return, have net earnings from self-employment and use either optional method to figure those net earnings?

No. Go to question 2.

Yes. Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

2. Are you claiming the earned income credit (EIC) on Form 1040, line 64, or Form 1040A, line 41?

Yes. Use the following chart to find the amount to enter on Form 8812, line 4.

IF you are filing Form	AND you completed	THEN enter on Form 8812, line 4, the amount from	
	Worksheet B on page 46 of your 1040 instructions or on page XX of Pub. 596	Worksheet B, line 4b.*	
1040	Step 6 on page 43 of your 1040 instructions (but not Worksheet B)	Step 6, Box A	
	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8	
10404	Step 6 on page 41 of your 1040A instructions	Step 6, Box A	
1040A	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8	

^{*} If you were a minister, member of a religious order who has not taken a yow of poverty, or a Christian Science practitioner, subtract the following from the amount on line 4b: (a) the rental value of a home or the nontaxable portion of an allowance for a home furnished to you (including payments for utilities) and (b) the value of meals and lodging provided to you, your spouse, and your dependents for your employer's

1040 filers: Go to question 3. **1040A filers:** Skip question 3 and go to question 4.

3. Were you, or your spouse if filing a joint return, self-employed, or are you filing Schedule SE because you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

No. Go to question 4.

Yes. Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

4. Does the amount on line 7 of Form 1040 or Form 1040A include any of the following amounts? Scholarship or fellowship grants not reported on a W-2 form.

- Amounts paid to an inmate in a penal institution for work (put "PRI" and the amount paid in the space next to line 7 of Form 1040 or 1040A).
- Amounts received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount received in the space next to line 7 of Form 1040 or 1040A). This amount may be reported in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

• Amounts from Form	2555,	line 41,	or Form	2555-EZ
line 18				

No.	Enter the amount from line 7 of Form 1040 or Form
	1040A on Form 8812, line 4.

Yes. Subtract the total of those amounts from the amount on line 7 of Form 1040 or Form 1040A. (If an amount is included in more than one of the above categories, include it only once in figuring the total amount to subtract.) Enter the result on Form 8812, line 4.

Railroad Employees

If you worked for a railroad, include the following taxes in the total on Form 8812, line 7.

- Tier 1 tax withheld from your pay. This tax should be shown in box 14 of your W-2 form(s) and identified as "Tier 1 tax."
- If you were an employee representative, 50% of the total tier 1 tax and tier 1 Medicare tax you paid for 2002.

1040A Filers

If you, or your spouse if filing a joint return, had more than one employer for 2002 and total wages of over \$84,900, figure any excess social security and tier 1 railroad retirement (RRTA) taxes withheld. See the instructions for Form 1040A, line 43. Include any excess on Form 8812, line 10.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: Recordkeeping, 6 min.; Learning about the law or the form, 5 min.; Preparing the form, 28 min.; Copying, assembling, and sending the form to the IRS, 20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the Instructions for Form 1040 or Form 1040A.



Exercise 1

Emily and Victor (SSN-000-00-4410) Howard are married taxpayers with four children. They file married filing jointly for 2002 on Form 1040A. All of their children are qualifying for purposes of the child tax credit. Their adjusted gross income is \$31,467, of which \$18,467 is taxable earned income and \$13,000 is unemployment compensation. Taxable income is \$5,797, Social Security/Medicare taxes are \$1,413 and the earned income credit is 569. Based on the facts given, figure the Howards:

- A. Child tax credit
- B. Additional child tax credit.

Exhibit 7 Complete this form.

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- **Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- **Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- **Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



- 1. Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly \$110,000
 - Single, head of household, or qualifying widow(er) \$75,000
 - Married filing separately \$55,000

☐ No. Continue

Yes. STOP

You must use Pub. 972 to figure your credit.

- **2.** Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
 - No. Use the worksheet on page 39 to figure your child tax credit.

Yes. You must use
Pub. 972 to figure your
child tax credit. You will
also need Form 8839.

Exhibit 8 Complete this form.

	orksheet—Line 33	Keep for Your Recor		
	Do not use this worksheet if you answered "Yes" to question 1 or 2 on page 38. Instead, use Pub. 972.			
1	• Number of qualifying children: × \$600. Enter the result.	1		
2	Enter the amount from Form 1040A, line 28.			
3	. Add the amounts from Form 1040A: Line 29			
	Line 30 + Line 31 + Line 32 + Enter the total. 3			
4	Yes. STOP You cannot take this credit because there is no tax to reduce. However, see the TIP below before completing the rest of your Form 1040A.			
5		4		
	 Yes. Enter the amount from line 4. Also, see the TIP below. No. Enter the amount from line 1. 	Enter this amount on Form 1040A, line 33.		
	You may be able to take the additional child tax credit on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above.			
	• First, complete your Form 1040A through line 41.			

Exhibit 9 Complete this form.

8812 Additional Child Tax Credit



OMB No. 1545-1620

	tment of the Treasury al Revenue Service	Complete and attach	to Form 1040 or Form 10	040A. 8812	Attachment Sequence No. 47
Name	e(s) shown on return			,	Your social security number
Par	rt I All Filer	s).
1	or page 37 of the	from line 1 of your Child Tax Credit Worksheet on e Form 1040A instructions. If you used Pub. 972 ge 3 of the publication			1
2	Enter the amount	t from Form 1040, line 50, or Form 1040A, line 3	33		2
3	Subtract line 2 fr	rom line 1. If zero, stop ; you cannot take this crea	lit		3
4 5	Is the amount on No. Leave	taxable earned income. See the instructions on back line 4 more than \$10,350? The line 5 blank and enter -0- on line 6. The part of the amount on line 4. Enter the			
6	Next. Do you have No. If line small Yes. If line	ount on line 5 by 10% (.10) and enter the result we three or more qualifying children? the 6 is zero, stop ; you cannot take this credit. The of line 3 or line 6 on line 13. the 6 is equal to or more than line 3, skip Part II 13. Otherwise, go to line 7.	_		6
Par		Filers Who Have Three or More Qualif	fying Children		<u> </u>
7	W-2, boxes 4 and	he withheld social security and Medicare taxes from 6. If married filing jointly, include your spouse's u worked for a railroad, see the instructions on ba	amounts		
8	1040 filers: E	then the total of the amounts from Form 1040, life and 57, plus any uncollected social security and addicare or tier 1 RRTA taxes included on line 61	and and		
•		-	9		
9 10		8	· · · - - - - - - - - - 		
	4 ta	inter the total of the amount from Form 1040A, I 1, plus any excess social security and tier 1 RR axes withheld that you entered to the left of line see the instructions on back).	RTA 10		
11	Subtract line 10	from line 9. If zero or less, enter -0			11
12	Enter the larger	of line 6 or line 11 here			12
	Next, enter the s	maller of line 3 or line 12 on line 13.			
Par	rt III Your Ac	dditional Child Tax Credit			
13	This is your ac	dditional child tax credit		1040 1040	Enter this amount on Form 1040, line 66, or Form 1040A, line 42.
For	 Paperwork Red	uction Act Notice, see back of form.	Cat. No. 10	0644E	Form 8812 (2002

Exhibit 10 Complete this form.

Form 8812 (2002) Page **2**

Instructions

Purpose of Form

Use Form 8812 to figure your additional child tax credit.



The additional child tax credit may give you a refund even if you do not owe any tax.

Who Should Use Form 8812

First, complete the Child Tax Credit Worksheet that applies to you. See the instructions for Form 1040, line 50, or Form 1040A, line 33. If you meet the condition given in the **TIP** at the end of your Child Tax Credit Worksheet, use Form 8812 to see if you can take the additional child tax credit.

Effect of Credit on Welfare Benefits

Any refund you receive as a result of taking the additional child tax credit will not be used to determine if you are eligible for the following programs, or how much you can receive from them.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

Taxable Earned Income

1. Did you, or your spouse if filing a joint return, have net earnings from self-employment and use either optional method to figure those net earnings?

No. Go to question 2	Ш
----------------------	---

Yes. Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

2. Are you claiming the earned income credit (EIC) on Form 1040, line 64, or Form 1040A, line 41?

Yes. Use the following chart to find the amount to enter on Form 8812, line 4.

IF you are filing Form	AND you completed	THEN enter on Form 8812, line 4, the amount from
	Worksheet B on page 46 of your 1040 instructions or on page XX of Pub. 596	Worksheet B, line 4b.*
1040	Step 6 on page 43 of your 1040 instructions (but not Worksheet B)	Step 6, Box A
	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8
1040A	Step 6 on page 41 of your 1040A instructions	Step 6, Box A
1040A	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8

^{*} If you were a minister, member of a religious order who has not taken a vow of poverty, or a Christian Science practitioner, subtract the following from the amount on line 4b: (a) the rental value of a home or the nontaxable portion of an allowance for a home furnished to you (including payments for utilities) and (b) the value of meals and lodging provided to you, your spouse, and your dependents for your employer's convenience.

No. 1040 filers: Go to question 3.

1040A filers: Skip question 3 and go to question 4.

3. Were you, or your spouse if filing a joint return, self-employed, or are you filing Schedule SE because you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

ı	No.	Go to	auestion	4
_	a ino.	00 10	duestion	4

Yes. Use Pub. 972 to figure the amount to enter on

Form 8812, line 4.

- **4.** Does the amount on line 7 of Form 1040 or Form 1040A include any of the following amounts?
- Scholarship or fellowship grants not reported on a W-2 form.
- Amounts paid to an inmate in a penal institution for work (put "PRI" and the amount paid in the space next to line 7 of Form 1040 or 1040A).
- Amounts received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount received in the space next to line 7 of Form 1040 or 1040A). This amount may be reported in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

•	Amounts	from	Form	2555,	line 4	41, o	r Form	2555-EZ,
lii	ne 18							

No.	Enter the amount from line 7 of Form 1040 or Form
	1040A on Form 8812, line 4.

П	×7	
ш	Yes.	Subtract the total of those amounts from the amount on
		line 7 of Form 1040 or Form 1040A. (If an amount is
		included in more than one of the above categories,
		include it only once in figuring the total amount to
		subtract.) Enter the result on Form 8812, line 4.

Railroad Employees

If you worked for a railroad, include the following taxes in the total on Form 8812, line 7.

- Tier 1 tax withheld from your pay. This tax should be shown in box 14 of your W-2 form(s) and identified as "Tier 1 tax."
- If you were an employee representative, 50% of the total tier 1 tax and tier 1 Medicare tax you paid for 2002.

1040A Filers

If you, or your spouse if filing a joint return, had more than one employer for 2002 and total wages of over \$84,900, figure any excess social security and tier 1 railroad retirement (RRTA) taxes withheld. See the instructions for Form 1040A, line 43. Include any excess on Form 8812, line 10.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 6 min.; **Learning about the law or the form**, 5 min.; **Preparing the form**, 28 min.; **Copying, assembling, and sending the form to the IRS**, 20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the Instructions for Form 1040 or Form 1040A.



Lesson 11

Answers to Exercises

Exercise 1 (A)

The Howard's Child Tax Eligibility Questions

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- Make sure you checked the box in column (4) of Step 2. line 6c on Form 1040A for each qualifying child.
- Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit of Step 3. if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



- 1. Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly \$110,000
 - Single, head of household, or qualifying widow(er) -\$75,000
 - Married filing separately \$55,000

🗵 No. Continue 🔼



You must use Pub. 972 to figure your credit.

- 2. Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
 - X No. Use the worksheet on page 39 to figure your child tax credit.

Yes. You must use Pub. 972 to figure your child tax credit. You will also need Form 8839.

CHILD TAX CREDIT

Answers to Exercises

Exercise 1 (A)

The Howard's Child Tax Worksheet

Tax Credit Wo	rksheet—Line 33	Keep for Your Record
Do not use this Instead, use Pu	worksheet if you answered "Yes" to question 1 or 2 on page 38. b. 972.	
1.	Number of qualifying children: $\phantom{aaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaa$	1 2,400
2.	Enter the amount from Form 1040A, line 28.	8
3.	Add the amounts from Form 1040A: Line 29	0
4.	Are the amounts on lines 2 and 3 the same? Yes. STOP You cannot take this credit because there is no tax to reduce. However, see the TIP below before completing the rest of your Form 1040A. No. Subtract line 3 from line 2.	4 57
5.	Is the amount on line 1 more than the amount on line 4?	Enter this amount on Form 1040A, line 33.
	You may be able to take the additional child tax credit on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above. • First, complete your Form 1040A through line 41. • Then, use Form 8812 to figure any additional child tax credit.	

CHILD TAX CREDIT

Lesson 11

Answers to Exercises

Exercise 1 (B)

The Howard's Additional Child Tax Credit, page 1

Form	8812	Additional Child Tax Credit	1040 1040A	OMB No. 1545-1620
	ment of the Treasury	Complete and attach to Form 1040 or Fo	8812	Attachment Sequence No. 47
	e(s) shown on return	Emily and Victor Howard		r social security number
Par	it I All Filer	s		70 100 1110
1	or page 37 of the	from line 1 of your Child Tax Credit Worksheet on page 38 of the Form 1040A instructions. If you used Pub. 972, enter the amount e 3 of the publication		2,400 00
2	Enter the amount	from Form 1040, line 50, or Form 1040A, line 33 $$		578 00
3 4 5	Enter your total t Is the amount on No. Leave	om line 1. If zero, stop ; you cannot take this credit	18,467 00 8,117 00	1,822 00
6	Next. Do you have No. If line small X Yes. If line	unt on line 5 by 10% (.10) and enter the result		812 00
Par	t II Certain	Filers Who Have Three or More Qualifying Children		
7	W-2, boxes 4 and	ne withheld social security and Medicare taxes from Form(s) 6. If married filing jointly, include your spouse's amounts a worked for a railroad, see the instructions on back	1,413 00	
8	29	nter the total of the amounts from Form 1040, lines of and 57, plus any uncollected social security and ledicare or tier 1 RRTA taxes included on line 61.	0 00	
0			1,413 00	
9 10		nter the total of the amounts from Form 1040, lines	1,110 00	
	1040A filers: E 4.	the did of the amount from Form 1040A, line I, plus any excess social security and tier 1 RRTA exes withheld that you entered to the left of line 43 ee the instructions on back).	569 00	
11	Subtract line 10 f	from line 9. If zero or less, enter -0-	1	<u>1</u> 844 00
12	_	of line 6 or line 11 here		844 00
_		maller of line 3 or line 12 on line 13.		
Pai	t III Your Ad	ditional Child Tax Credit		
13	This is your ac	lditional child tax credit	1000 T	844 00 Enter this amount on Form 1040, line 66, or Form 1040A, line 42.
		uction Act Notice, see back of form. Cat.		Form 8812 (2002)

Introduction

In this section, you will complete tax returns for several common wage earner scenarios often encountered at volunteer assistance sites. This will be valuable practice as you prepare to help taxpayers. Although answers to each of the problems are shown at the end of this section, you should try to complete the blank forms for each problem before referring to its answers.

After completing this section, you will be able to:

■ accurately complete a basic tax return.

Problem 1

Nathan Ramsey, a senior in high school, wants help with preparing his tax return. He tells you he will be 18 years old next week, lives with his parents, who claim him as a dependent, and two siblings. He has a Form W-2 showing wages of \$1,387 and Federal withholding of \$4. He also has a Form 1099-INT from his savings account for \$37. His social security number (SSN) is 123-00-0123. Nathan lives at 3497 Livingston St., N.E., Elgin, IL 60123. Nathan wants to contribute to the Presidential Election Campaign Fund. Any refund should be mailed to his home.

You are a volunteer at VITA Site 13B, on April 10, 2003.

Complete this form. Form 1040EZ, front

1040EZ	Income Tax Return for Single and Joint Filers With No Dependents (99) 2002	OMB No. 1545-0675
-11	Your first name and initial Last name	Your social security number
Label	L	
See page 12.)	A B If a joint return, spouse's first name and initial Last name	Spouse's social security number
Jse the IRS abel.	E L	
Otherwise, blease print	Home address (number and street). If you have a P.O. box, see page 12. Apt. no. Apt. no. City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.	▲ Important! ▲
	E City, town or post office, state, and zip code. If you have a foreign address, see page 12.	You must enter your SSN(s) above.
Election Campaign	Note. Checking "Yes" will not change your tax or reduce your refund.	You Spouse
page 12)	Do you, or your spouse if a joint return, want \$3 to go to this fund?	□Yes □No □Yes □No
ncome	1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1
Attach Form(s) W-2	2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.	2
nere. Enclose, but	3 Unemployment compensation and Alaska Permanent Fund dividends	-
do not attach, any payment.	(see page 14).	3
	4 Add lines 1, 2, and 3. This is your adjusted gross income.	4
Note. You)	5 Can your parents (or someone else) claim you on their return?	
nust check }	Yes. Enter amount from No. If single, enter \$7,700. worksheet on back. If married, enter \$13.850.	
es or No.	worksheet on back. If married , enter \$13,850. See back for explanation.	5
	6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0 This is your taxable income.	6
)	This is your taxable income.	0
Payments and tax	7 Federal income tax withheld from box 2 of your W-2 form(s).	7
	8 Earned income credit (EIC).	8
	9 Add lines 7 and 8. These are your total payments.	9
	10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages	,
	24-28 of the booklet. Then, enter the tax from the table on this line.	10
Refund	11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your refund.	11a
lave it directly eposited! See	▶ b Routing number	
age 20 and fill in 1b, 11c, and 11d.	▶ d Account number	
Amount ou owe	12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the amount you owe. For details on how to pay, see page 21.	12
	Do you want to allow another person to discuss this return with the IRS (see page 22)?	
Third party	Designee's Phone Personal idea	
lesignee	name ► no. ► () number (PIN)	>
Sign	Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and be accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other t	
nere	on all information of which the preparer has any knowledge. Your signature Date Your occupation	Daytime phone number
oint return? See page 11.		
Keep a copy or your ecords.	Spouse's signature. If a joint return, both must sign. Date Spouse's occupation	
Paid	Preparer's signature Date Check if self-employed	Preparer's SSN or PTIN
reparer's	signature self-employed self-employed Firm's name (or	<u> </u>
ise only	yours if self-employed), address, and ZIP code Phone no.	()
	Privacy Act, and Paperwork Reduction Act Notice, see page 23. Cat. No. 11329V	Form 1040EZ (2002

Complete this form. Form 1040EZ, back

Form 1040EZ (2002) Page 2

Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had only wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. But if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you cannot use this form, use TeleTax topic 352 (see page 6).

Filling in vour return

For tips on how to avoid common mistakes, see page 30.

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

A. Amount, if any, from line 1 on front
+ 250.00 Enter total ► A
B. Minimum standard deduction
C. Enter the larger of line A or line B here
D. Maximum standard deduction. If single , enter \$4,700; if married , enter \$7,850
E. Enter the smaller of line C or line D here. This is your standard deduction
F. Exemption amount.
• If single, enter -0
• If married and—
—both you and your spouse can be claimed as dependents, enter -0
—only one of you can be claimed as a dependent, enter \$3,000.
G. Add lines E and F. Enter the total here and on line 5 on the front G.
u checked "No" on line 5 because no one can claim you (or your spouse if married) as a ndent, enter on line 5 the amount shown below that applies to you.

If yo depe

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by April 15, 2003. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



Form **1040EZ** (2002)

Problem 2

Mary Duvall is 36 years old and single. Her social security number is 000-00-1234. Mary earned \$6,900 as a clerk before being laid off in October. Her income tax withholding from box 2 of her Form W-2 is \$800. For the remainder of 2002, she received \$950 in unemployment compensation. Mary had no other income. She lives at 46 Maple Lane, Atlanta, GA 30365. Mary does not want to contribute to the Presidential Election Campaign Fund. Any refund is to be directly deposited into her checking account at her bank. She shows you her check: the routing number is 250250025; the account number is 20202086.

Complete a tax return for Mary Duvall. You are a VITA volunteer at Site 123, on March 3, 2003.

Complete this form. Form 1040EZ, front

1040EZ	Joint Filers With No De	ependents (99) 2002		OMB No. 1545-0675	
Label	Your first name and initial	Last name	Your social	security number	
See page 12.) Use the IRS	A B E If a joint return, spouse's first name and initial	Last name	Spouse's so	cial security number	
abel. Otherwise, please print or type.	Home address (number and street). If you have City, town or post office, state, and ZIP code. If		You m ı	oortant! A ust enter your N(s) above.	
Presidential Election Campaign (page 12)	Note. Checking "Yes" will not chang Do you, or your spouse if a joint ret		You Yes	Spouse	
Income	1 Total wages, salaries, and tips. The form(s). Attach your W-2 form(s)		our W-2		
Attach Form(s) W-2 nere.	2 Taxable interest. If the total is over		0EZ. 2		
Enclose, but do not attach, any payment.	3 Unemployment compensation and (see page 14).	d Alaska Permanent Fund dividen	ds 3		
ang paymont.	4 Add lines 1, 2, and 3. This is you		4		
Note. You must check Yes or No.	5 Can your parents (or someone els Yes. Enter amount from worksheet on back.	No. If single, enter \$7,700 If married, enter \$13 See back for explanat	,850.		
	6 Subtract line 5 from line 4. If lin This is your taxable income.	e 5 is larger than line 4, enter -0-			
Payments and tax	7 Federal income tax withheld from	7			
	8 Earned income credit (EIC).		8		
	9 Add lines 7 and 8. These are you	r total payments.	> 9		
	10 Tax. Use the amount on line 6 at 24–28 of the booklet. Then, enter	bove to find your tax in the tax tar the tax from the table on this lir			
Refund	11a If line 9 is larger than line 10, su	abtract line 10 from line 9. This is	your refund. ► 11a		
Have it directly deposited! See page 20 and fill in	▶ b Routing number	▶ c Type:	Checking Savings		
11b, 11c, and 11d.	▶ d Account number				
Amount you owe	12 If line 10 is larger than line 9, subthe amount you owe. For details	btract line 9 from line 10. This is on how to pay, see page 21.	▶ 12		
Third party designee	Do you want to allow another person to	Phone	Personal identification	he following. N	
Sign here Joint return? See page 11.	name no. () number (PIN) Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge. Your signature Daytime phone number				
Keep a copy for your records.	Spouse's signature. If a joint return, both mu	ust sign. Date Spouse's	s occupation	1	
Paid oreparer's	Preparer's signature	Date	Check if self-employed	s SSN or PTIN	
use only	Firm's name (or yours if self-employed), address, and ZIP code		EIN :		

Complete this form. 2002 Form 1040EZ, page 2

Use this form if

Form 1040EZ (2002)

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had only wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400.
 But if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you cannot use this form, use TeleTax topic 352 (see page 6).

Filling in your return

For tips on how to avoid common mistakes, see page 30.

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

A. Amount, if any, from line 1 on front		
•	+ 250.00 Enter total ▶	A
B. Minimum standard deduction		. B. 750.00
C. Enter the larger of line A or line B h		
D. Maximum standard deduction. If sing enter \$7,850	-	D
E. Enter the smaller of line C or line D deduction	2	. E
F. Exemption amount.	,	
• If single, enter -0		
• If married and—		F.
-both you and your spouse can be	claimed as dependents, enter -0	
-only one of you can be claimed as	s a dependent, enter \$3,000.	
G. Add lines E and F. Enter the total her	re and on line 5 on the front.	. G
checked "No" on line 5 because no one	e can claim vou (or vour spouse	if married) as a

If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by April 15, 2003. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



Form **1040EZ** (2002)

Page 2

Complete this form.

Line 8 Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.



If you have a qualifying child (see the next column on this page), you may be able to take the credit, but you must use Schedule EIC and Form 1040A or 1040 to do so. For details, see Pub. 596.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet on page 19 or let the IRS figure the credit for you.

You Will Need:







If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1

All Filers

1. Is the amount on Form 1040EZ, line 4, less than \$11,060 (or \$12,060 if married filing jointly)?

	Yes.	Continue	₹
--	------	----------	---



You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 18)?





You cannot take the credit. Print 'No" in the space to the left of line 8.

3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?



☐ No. Continue >

	6.	Look or yo of ar
		You
		Your your
		A f

1. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

☐ **Yes.** Go to question 5.

No. STOP

You cannot take the credit.

Enter 'No" in the space
to the left of line 8.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 17 before you answer.

Yes. Continue



You cannot take the credit. Enter 'No" in the space to the left of line 8.

6. Look at the qualifying child conditions below. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

☐ Yes. STOP

You cannot take the credit. Enter 'No" in the space to the left of line 8.

No. Go to Step 2 on page 18.



A qualifying child is a child who is-

Your son, daughter, adopted child, stepchild, or grandchild

Your brother, sister, stepbrother, stepsister or a descendant of your brother, sister, etc. (for example, your niece or nephew)

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)



was at the end of 2002...

Under age 19

or

Under age 24 and a student

or

Any age and permanently and totally disabled



who...

Either lived with you in the United States for more than half of 2002 or was born or died in 2002 and your home was the child's home for the entire time he or she was alive in 2002.

Note. Special rules apply if the child was married or also meets the conditions to be a qualifying child of another person (other than your spouse if filing a joint return). For details, use TeleTax topic 601 (see page 8) or see Pub. 596.

(Continued on page 18)

Continued from page 17

Step 2 **Earned Income 1.** Figure earned income: Form 1040EZ, line 1 Subtract, if included on line 1, any: • Taxable scholarship or fellowship grant not reported on a W-2 form Amount paid to an inmate in a penal institution for work (enter "PRI" in the space to the left of line 1 of Form 1040EZ) Amount received as a pension or annuity from a nonqualified deferred compensation plan or a section 457 plan (enter "DFC" in the space to the left of line 1 of Form 1040EZ). This amount may be shown in box 11 of

Earned Income =

your W-2 form. If you received such

contact your employer for the amount

an amount but box 11 is blank,

received as a pension or annuity.

Box			
C			

2. Is Box A less than \$11,060 (or \$12,060 if married filing jointly)?

Yes.	G_{α}	to	Ctan	2
res.	GO	ιo	stev	3.



You cannot take the credit. Print "No" in the space to the left of line 8.

Step 3 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. See Credit
Figured by the IRS
on this page.

No. Go to the worksheet on page 19.

Definitions and Special Rules

(listed in alphabetical order)

Credit Figured by the IRS. To have the IRS figure the credit for you:

- Enter "EIC" in the space to the left of line 8 of Form 1040EZ.
- If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

Members of the Military. If you were on extended active duty outside the United States, your home is considered to be in the United States during that duty period. Extended active duty is military duty ordered for an indefinite period or for a period of more than 90 days. Once you begin serving extended active duty, you are considered to be on extended active duty even if you serve fewer than 90 days.

Social Security Number (SSN). For purposes of taking the EIC, a valid SSN is a number issued by the Social Security Administration unless "Not Valid for Employment" is printed on the social security card and the number was issued solely to apply for or receive a Federally funded benefit.

To find out how to get an SSN, see page 14. If you will not have an SSN by April 15, 2003, see What if You Cannot File on Time? on page 11.

Welfare Benefits, Effect of Credit on. Any refund you receive as a result of taking the EIC will not be used to determine if you are eligible for the following programs, or how much you can receive from them. But if the refund you receive because the EIC is not spent within a certain period of time, it may count as an asset (or resource) and affect your eligibility.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

(Continued on page 19)

All Filers 2. L file he If E 3. E 4. A Part 2 Filers Who Answered 'No" on	nter your total earned income from Step 2, lox A, on page 18. Took up the amount on line 1 above in the EIC Table on page 20 to and the credit. Use the column for your filing status. Enter the credit ere. The state of the space to the left of line 8. The state amount from Form 1040EZ, line 4. The state amount on lines 3 and 1 the same? Yes. Skip line 5; enter the amount from line 2 on line 6. No. Go to line 5. The state amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? Yes. Leave line 5 blank; enter the amount from line 2 on line 6. No. Look up the amount on line 3 in the EIC Table on page 20 to find the credit. Use the column for your filing status.	2
Part 2 Filers Who Answered 'No" on	Yes. Skip line 5; enter the amount from line 2 on line 6. No. Go to line 5. The amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? Yes. Leave line 5 blank; enter the amount from line 2 on line 6. No. Look up the amount on line 3 in the EIC Table on page 20	
Filers Who Answered 'No" on	Yes. Leave line 5 blank; enter the amount from line 2 on line 6. No. Look up the amount on line 3 in the EIC Table on page 20	
Line 4	Enter the credit here. Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6.	5
Part 3 6. T Your Earned Income Credit	This is your earned income credit.	Enter this amount on Form 1040EZ, line 8.
	If your EIC for a year after 1996 was reduced or disallowed, see page 18 to find out if you must file Form 8862 to take the credit for 2002.	[lustor]

Problem 3

Albert W. Rowan, SSN 000-00-7698 is 55. He lives at 1515 Kingston Court, Charlotte, NC 28215. He does not want to contribute \$3 to the Presidential Election Campaign Fund. Albert's grandson, Derek K. Rowan, SSN 000-00-6568, was born in 1994 and lived with Albert all of 2002. Albert provided all of his grandson's support.

Albert earned \$22,552 as a security officer for a local textile mill, and he had \$1,850 of taxes withheld from his wages. He had no other source of income. Albert received \$360 in advance earned income credit payments. While he worked, Albert paid Maude Lee Child Care Center, 551 Cower Street, Charlotte, NC 28215, EIN 10-9963246, to provide after school care for Derek. Albert paid \$1,500 for Derek's after school care. Albert wants a refund of any overpayment directly deposited by IRS into his checking account. When you ask him for the information for direct deposit, he shows you a check that has a routing number of 320360036 and an account number of 40403075.

You are a VITA volunteer at Site # 500. Prepare Albert's tax return. It is Jan. 24, 2003.

Complete this form. Form 1040A, page 1

Form 1040A	U.S. Individual Income 1		2002 IRS Us	e Only—Do not writ	e or staple in this s	расе
	Your first name and initial	Last name	2 2 =3 00		OMB No. 1545-0085	
Label				Your so	cial security numb	oer
See page 19.)					1 1	
B	If a joint return, spouse's first name and initial	Last name		Spouse	s social security nur	mbe
Use the				7	1 1	
IRS label. Otherwise,	Home address (number and street). If you have a	a P.O. box, see page 20.	Apt.	10.	mportant!	
please print E	City, town or post office, state, and ZIP code. If	you have a foreign address, see pa	ge 20.	You	must enter yo	
				<u> </u>	SSN(s) above.	
Presidential Election Campaign	Note. Checking "Yes" will not cha	ange your toy or reduce yo	ur refund	You	ı Spous	e
See page 20.)	Do you, or your spouse if filing a			Yes	No □Yes	
	1 ☐ Single			old (with qualifying	person). (See page	01
Filing	2 Married filing jointly (even if o	nly one had income)			out not your depen	
status	3 Married filing separately. Ente			s name here. ►	out not your dopon	IGOII
Check only	full name here. ►	r opouse o convusovo une	5 Qualifying v		dependent ch	nild
one box.			(year spous). (See page	
Exemptions	6a Yourself. If your pare	ent (or someone else)	can claim you as	a)	No. of boxes	
	dependent	on his or her tax retu			checked on 6a and 6b	
	b Spouse		1	<u> </u>	No. of children	
	c Dependents:	(2) Dependent's social	(3) Dependent's	(4) √if qualifying child for child	on 6c who: Iived with	
	(1) First name Last name	security number	relationship to you	tax credit (see	you	
If more than six	(1) I list harrie Last harrie	!!!	you	page 23)	• did not live	
dependents, see page 22.		1 1			with you due to divorce or	
				 	separation (see page 24)	
	-	i i		 		
	-				Dependents on 6c not	
				 	entered above	
					Add numbers	П
	d Total number of exemption	ons claimed.			on lines above	_
Income		=		_		
Attach	7 Wages, salaries, tips, etc	. Attach Form(s) W-2.	•	7		
Form(s) W-2	On Tourney Street Attack	0 - - - 4 16 11 - - - - - - - - - - - - -	1	0-		
here. Also	8a Taxable interest. Attach Schedule 1 if required. 8a b Tax-exempt interest. Do not include on line 8a. 8b					
attach Form(s)				9		
1099-R if tax	9 Ordinary dividends. Attach Schedule 1 if required. 9					
was withheld.	10 Capital gain distributions	(see page 25).		10		
If you did not	11a IRA	(ccc page 10).	11b Taxable amo			
get a W-2, see	distributions. 11a		(see page 2	=\		
page 25.	12a Pensions and		12b Taxable amo			
Enclose, but do not attach, any	annuities. 12a		(see page 2	6). 12b		
payment.	13 Unemployment compens	ation and Alaska Par	manant Fund divid	dends. 13		
	13 Unemployment compens14a Social security	alion and Alaska Fen	14b Taxable am			
	benefits. 14a		(see page 2			
	Bollotta. 14a		(See page 2	0). 146		
	15 Add lines 7 through 14b (f	ar right column). This i	s your total incom	e. ▶ 15		
Adjusted	16 Educator expenses (see page 1		16			
gross	17 IRA deduction (see page 2		17			
income	18 Student loan interest dedu	iction (see page 31).	18			
	19 Tuition and fees deduction	(see page XX).	19			
	20 Add lines 16 through 19.	These are your total	adjustments.	20		
	21 Subtract line 20 from line	15 This is your adjust	ed gross income	▶ 21		
		io. Iilio lo your aujuot	WI COO IIICUIIIC.	- 41		İ

Complete this form. Form 1040A, page 2 Form 1040A (2002) Page 2 Enter the amount from line 21 (adjusted gross income). 22 22 Tax, credits, Check ∫ ☐ You were 65 or older ☐ Blind \ Enter number of and ☐ Spouse was 65 or older ☐ Blind ∫ boxes checked ▶ payments If you are married filing separately and your spouse itemizes Standard deductions, see page 32 and check here Deduction Enter your standard deduction (see left margin). for-• People who 25 Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-. 25 checked any 26 Multiply \$3,000 by the total number of exemptions claimed on line 6d. 26 box on line 23a or 23b or 27 Subtract line 26 from line 25. If line 26 is more than line 25, enter -0who can be claimed as a This is your taxable income. dependent. Tax, including any alternative minimum tax (see page 33) 28 see page 33. 29 Credit for child and dependent care expenses. · All others: Attach Schedule 2. Single, \$4,700 30 Credit for the elderly or the disabled. Attach Head of Schedule 3. 30 household, \$6,900 31 Education credits. Attach Form 8863. 31 Married filing Retirement savings contributions credit. Attach 32 iointly or Form 8880. Qualifying 32 widow(er), \$7,850 Child tax credit (see page 36). 33 33 34 Adoption credit. Attach Form 8839 34 Married 35 Add lines 29 through 34. These are your total credits. filing separately, \$3,925 Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-36 36 37 Advance earned income credit payments from Form(s) W-2. 37 38 Add lines 36 and 37. This is your total tax. 38 39 Federal income tax withheld from Forms W-2 39 and 1099. 40 2002 estimated tax payments and amount If you have applied from 2001 return. a qualifying 41 Earned income credit (EIC). 41 child, attach Schedule 42 Additional child tax credit. Attach Form 8812. 43 Add lines 39 through 42. These are your total payments. **▶** 43 44 If line 43 is more than line 38, subtract line 38 from line 43. Refund 44 This is the amount you overpaid. ▶ 45a Direct Amount of line 44 you want refunded to you. deposit? Routing **▶** b See page 47 ▶ c Type: ☐ Checking ☐ Savings number 45b, 45c, Account **▶** d and 45d. number 46 Amount of line 44 you want applied to your 2003 estimated tax. 46 47 Amount you owe. Subtract line 43 from line 38. For details on how Amount **▶** 47 to pay, see page 48. you owe Estimated tax penalty (see page 48) 48 Do you want to allow another person to discuss this return with the IRS (see page 49)? 🗌 Yes. Complete the following. 🗆 No Third party designee Designee's Personal identification name no. number (PIN) Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration Sign of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge. here Daytime phone number Your occupation Date Your signature Joint return? See page 20. Кеер а сору Spouse's signature. If a joint return, both must sign. Date Spouse's occupation for your records. Date Preparer's SSN or PTIN Preparer's signature Paid Check if self-employed preparer's Firm's name (or yours if self-employed), address, and ZIP code EIN use only Phone no. Form **1040A** (2002) ➂

CW-12 Comprehensive Problems

WAGE EARNER

Complete this form. Schedule 2, page 1 Department of the Treasury-Internal Revenue Service Schedule 2 Child and Dependent Care (Form 1040A) 2002 **Expenses for Form 1040A Filers** OMB No. 1545-0085 Name(s) shown on Form 1040A Your social security number Before you begin: You need to understand the following terms. See Definitions on page 1 of the separate instructions. Dependent Care Benefits
 Qualifying Person(s)
 Qualified Expenses Earned Income (a) Care provider's (b) Address (number, street, apt. no., (c) Identifying (d) Amount paid Part I name city, state, and ZIP code) number (SSN or EIN) (see instructions) Persons or organizations who provided the care (If you need more space, use the bottom of page 2.) You must complete this Complete only Part II below. Did you receive part. dependent care benefits? Yes -Complete Part III on the back next. Caution. If the care was provided in your home, you may owe employment taxes. If you do, you must use Form 1040. See Schedule H and its instructions for details. Information about your qualifying person(s). If you have more than two qualifying persons, see Part II the instructions. (c) Qualified expenses Credit for child (a) Qualifying person's name (b) Qualifying person's social you incurred and paid and dependent in 2002 for the person security number First Last care expenses listed in column (a) Add the amounts in column (c) of line 2. Do not enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26. 4 Enter your earned income. 4 5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); all others, enter the amount from line 4. 5 6 Enter the **smallest** of line 3, 4, or 5, 6 Enter the amount from Form 1040A, line 22. Enter on line 8 the decimal amount shown below that applies to the amount on line 7. If line 7 is: If line 7 is: **But not** Decimal But not Decimal Over over amount is Over over amount is \$0-10,000 .30 \$20,000-22,000 .24 .23 10,000-12,000 .29 22,000-24,000 12,000-14,000 .28 24,000-26,000 .22 14,000—16,000 26,000-28,000 .27 .21 16,000—18,000 28,000-No limit .26 .20 18,000-20,000 .25 8 Multiply line 6 by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions. 9 10 Enter the amount from Form 1040A, line 28. 10 Credit for child and dependent care expenses. Enter the smaller of line 9 or line 10 here and on Form 1040A, line 29. 11 Schedule 2 (Form 1040A) 2002 For Paperwork Reduction Act Notice, see Form 1040A instructions. Cat. No. 10749I

Complete this form.

Form 1040A Child Tax Credit Worksheet

Child Tax Credit W	Vorksheet—Line 33	Keep for Your Records
Do not use t Instead, use	his worksheet if you answered "Yes" to question 1 or 2 on page 38. Pub. 972.	
	1. Number of qualifying children: × \$600. Enter the result. 2. Enter the amount from Form 1040A, line 28. 2. Add the amounts from Form 1040A: Line 29 Line 30 + Line 31 + Line 32 + Enter the total. 3. Are the amounts on lines 2 and 3 the same? Yes. STOP You cannot take this credit because there is no tax to reduce. However, see the TIP below before	
	completing the rest of your Form 1040A. No. Subtract line 3 from line 2. Is the amount on line 1 more than the amount on line 4? Yes. Enter the amount from line 4. Also, see the TIP below. No. Enter the amount from line 1.	Enter this amount on Form 1040A, line 33.
	You may be able to take the additional child tax credit on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above. • First, complete your Form 1040A through line 41. • Then, use Form 8812 to figure any additional child tax credit.	1040A

Complete this form.

Form 1040A EIC Worksheet

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1

All Filers

- 1. If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. Continue	3
---------------	---



You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes.	Continue	2
		$\overline{}$



You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Is your filing status married filing separately?

_		STOP	
Ш	Yes	. (3101)	
	You	cannot	take
	the o	credit.	

No. Continue



4. Were you a nonresident alien for any part of 2002?

Yes. See Nonresideni	∥ No.	Go to Step 2	2.
Aliens on page 44.			

5	Step 2 Investment	Income
1.	Add the amounts from	Line 8a
	Form 1040A:	Line 8b +
		Line 9 +
		Line 10 +
	Investment	Income =
2.	Is your investment income	more than \$2,550?
	Yes. STOP You cannot take the credit.	☐ No. Continue
3.	Did a child live with you is	n 2002?
	☐ Yes. Go to Step 3.	□ No. Go to Step 4 on page 42.

(Continued on page 42)

Form 1040A EIC Worksheet

Continued from page 41	
Step 3 Qualifying Child A qualifying child is a child who is	3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?
Your son, daughter, adopted child, stepchild, or grandchild Or Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child Or	☐ Yes. See Qualifying Child of More Than One Person on page 44. No. This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. Skip Step 4; go to Step 5 on page 43.
A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child) If the child was married, see page 42.	Step 4 Filers Without a Qualifying Child
was at the end of 2002 Under age 19 or Under age 24 and a student (see page 44)	1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002? Yes. STOP You cannot take the credit. Put "No" to the left of the entry space for line 41.
Any age and permanently and totally disabled (see page 44) AND	2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return? Yes. Stop You cannot take the credit.
who Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44. Note. If the child was married, see page 44.	Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002? Yes. Continue You cannot take the credit. Put "No" to the left of the entry space for line 41.
1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002? Yes. STOP You cannot take the credit. Put "No" to the left of the entry space for line 41.	4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer. Yes. Go to Step 5 on page 43. You cannot take the credit. Put "No" to the left of the entry space for line 41.
2. Do you have at least one child who meets the above conditions to be your qualifying child? \[\begin{align*} \text{ No. Skip question 3; go to Step 4, question 2.} \end{align*}	
	(Continued on page 41)

Complete this form. Form 1040A EIC Worksheet

Step 5 Earned Income	Step 6 How To Figure the Credit
Figure earned income:	1. Do you want the IRS to figure the credit for you?
Form 1040A, line 7	Yes. See Credit No. Go to the worksheet
Subtract, if included on line 7, any:	Figured by the IRS on page 44.
• Taxable scholarship or fellowship grant not reported on a W-2 form	below.
 Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A) Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 	Definitions and Special Rules (listed in alphabetical order) Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorize by state law to place children for legal adoption. The adoption does not have to be final.
plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A).	Credit Figured by the IRS. To have the IRS figure the credit for you:
This amount may be shown in box 11 of your W-2 form. If you received such an amount but box	1. Put "EIC" to the left of the entry space for line 41 o Form 1040A.
11 is blank, contact your employer for the amount received as a pension or annuity. Taxable Earned Income =	2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must Fi on page 44.
Go to Step 6. If you have: 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)? 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)? No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)? Yes. Go to Step 6.	remporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.
You cannot take the credi	Form 8862, Who Must File. You must file Form 8862 is your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do n file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:
	You filed Form 8862 (or other documents) and your EIC was then allowed and
	 Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.
	Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intention

Complete this form. Form 1040A EIC Worksheet

arned Income	Credit (EIC) Worksheet—Line 41 Keep for	or Your Records
Part 1 All Filers	 Enter your earned income from Step 5, on page 43. Look up the amount on line 1 above in the EIC Table on pages 46–51 	
	to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41.	
	3. Enter the amount from Form 1040A, line 22.	
	4. Are the amounts on lines 3 and 1 the same? ☐ Yes. Skip line 5; enter the amount from line 2 on line 6. ☐ No. Go to line 5.	
Part 2 Filers Who Answered "No" on Line 4	 5. If you have: No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)? ☐ Yes. Leave line 5 blank; enter the amount from line 2 on line 6. ☐ No. Look up the amount on line 3 in the EIC Table on pages 46-51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. 	5
	Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6.	
Part 3 Your Earned Income Credit	6. This is your earned income credit.	Enter this amount on Form 1040A, line 41.
	Reminder— √ If you have a qualifying child, complete and attach Schedule EIC.	1040A
	If your EIC for a year after 1996 was reduced or disallowed, se page 44 to find out if you must file Form 8862 to take the credit for 2002.	e

2002 Schedule EIC

Complete this form. **SCHEDULE EIC Earned Income Credit** OMB No. 1545-0074 1040A (Form 1040A or 1040) Qualifying Child Information 1040 Department of the Treasury Complete and attach to Form 1040A or 1040 Attachment Sequence No. 43 only if you have a qualifying child. Internal Revenue Service Your social security number Name(s) shown on return See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that Before you begin: (a) you can take the EIC and (b) you have a qualifying child. • If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details. It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child. Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Q	ualifying Child Information		Child 1	C	hild 2
1	Child's name If you have more than two qualifying children, you only have to list two to get the maximum credit.	First name	Last name	First name	Last name
2	Child's SSN The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.				
3	Child's year of birth	Year If born afte and 4b; go	er 1983, skip lines 4a to line 5.	Year If born after 19 and 4b; go to be	983, skip lines 4a line 5.
-	If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student?	Yes.	No. 5. Continue	Yes. Go to line 5.	No.
b	Was the child permanently and totally disabled during any part of 2002?	Yes.	No. The child is not a qualifying child.	Yes. Continue	No. The child is not a qualifying child.
5	Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)				
6	Number of months child lived with you in the United States during 2002 • If the child lived with you for more than half of				
	 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	Do not ent	months	Do not enter n	months more than 12 months.



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2002

Problem 1

1040EZ	Joint Filers With No De	pendents (99) 2	2002			OMB No. 1545	5-0675
Label	Your first name and initial Nathan	Last name Ramsey				l security numl	ber
See page 12.)	L A B If a joint return, spouse's first name and initial	Last name				$00 \mid 0123$	ımber
Jse the IRS abel. Otherwise, blease print	Home address (number and street). If you have 3497 Livingston St. N.E	1.		Apt. no.	-	portant	
or type. Presidential	City, town or post office, state, and ZIP code. If Elgin, IL 60123	f you have a foreign address, se	e page 12.			nust enter you N(s) above.	our
Election Campaign page 12)	Note. Checking "Yes" will not chang Do you, or your spouse if a joint retr				You X Yes □	Spouse	
ncome	1 Total wages, salaries, and tips. The form(s). Attach your W-2 form(s).	is should be shown in b		2	1	1,387	oc
Attach Form(s) W-2	2 Taxable interest. If the total is ove		Form 1040EZ.		2	37	00
ere. Enclose, but do not attach,	3 Unemployment compensation and (see page 14).				3		
any payment.	4 Add lines 1, 2, and 3. This is you				4	1,424	00
Note. You nust check /es or No.	5 Can your parents (or someone else Yes. Enter amount from worksheet on back.	No. If single, end			5	1,637	00
	6 Subtract line 5 from line 4. If line This is your taxable income.	e 5 is larger than line 4,	enter -0	>	6	0	00
Payments and tax	7 Federal income tax withheld from	box 2 of your W-2 form	n(s).		7	4	00
	8 Earned income credit (EIC).				8	0	00
	9 Add lines 7 and 8. These are your	total payments.		•	9	4	00
	10 Tax. Use the amount on line 6 ab 24–28 of the booklet. Then, enter			pages	10	0	00
Refund	11a If line 9 is larger than line 10, sub	btract line 10 from line	9. This is your 1	refund.	11a	4	0
Have it directly deposited! See page 20 and fill in 1b, 11c, and 11d.	▶ b Routing number ▶ d Account number	<u></u>	Type: Check	cing Savings			
Amount	12 If line 10 is larger than line 9, sub the amount you owe. For details of			<u> </u>	12		
ou owe Third party	Do you want to allow another person to			ge 22)?		the following.	N
designee	Designee's name ► Under penalties of perjury, I declare that I have	Phone no.)	Personal ide	▶_	acreet and	
Sign here Joint return? See page 11.	accurately lists all amounts and sources of inc on all information of which the preparer has a Your signature Nathan Ramsey	han the taxpay	ver) is based e phone numbe	er			
Keep a copy or your ecords.	Spouse's signature. If a joint return, both must	st sign. Date	Spouse's occupa	ation			
Paid preparer's	Preparer's VITA Site 13B		Date	Check if self-employed	Preparer'	s SSN or PTIN	
ise only	Firm's name (or yours if self-employed), address, and ZIP code			EIN Phone no.			

Form 1040EZ (2002) Page **2**

Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had **only** wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. **But** if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you **cannot use this form**, use TeleTax topic 352 (see page 6).

Filling in your return

For tips on how to avoid common mistakes, see page 30. If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

A. Amount, if any, from line 1 on front $\frac{1,387.00}{}$		
+ 250.00 Enter total ►	A	1,637.00
B. Minimum standard deduction		750.00
C. Enter the larger of line A or line B here	. C	1,637.00
D. Maximum standard deduction. If single , enter \$4,700; if married , enter \$7,850	D. _	4,700.00
E. Enter the smaller of line C or line D here. This is your standard deduction	. E	1,637.00
F. Exemption amount.	١	
• If single, enter -0		
• If married and—	} F	
—both you and your spouse can be claimed as dependents, enter -0		
—only one of you can be claimed as a dependent, enter \$3,000.		
G. Add lines E and F. Enter the total here and on line 5 on the front	. G	1,637.00

If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by **April 15, 2003.** Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



Form **1040EZ** (2002)

Problem 2

Form 1040EZ		Income Tax I Joint Filers V	Return for S	ingle		2002		0	MB No. 1545	5-0675
Label		Your first name and initial		Last na				Your social se	curity numl	ber
(See page 12.)	L	Mary If a joint return, spouse's fire	est name and initial	Duva Last na				000 00 Spouse's socia		
Use the IRS	B E	ii a joint return, spouse's iii	st name and miliai	Last nai	nie			Spouse's socia	;	iiiibei
Iabel. Otherwise, please print or type.	H E R	Home address (number and 46 Maple Lane City, town or post office, st				ee page 12.	Apt. no.	▲ Impo		
	E	Atlanta, GA 30	•		g,				above.	, di
Presidential Election Campaign (page 12)		Note. Checking "Yes" Do you, or your spou	will not change					You Yes X No	Spouse Yes	
Income		Total wages, salarie form(s). Attach you		should	be shown in l	box 1 of your W-2		1	6,900	00
Attach Form(s) W-2	2	2 Taxable interest. If	the total is over	\$400. vc	ou cannot use	Form 1040FZ		2		
here. Enclose, but	_	Unemployment cor			4					T
do not attach, any payment.	_	(see page 14).						3	950	00
	2	Add lines 1, 2, and	1 3. This is your	adjusted	l gross incon	ne.		4	7,850	00
Note. You must check Yes or No.	5	Yes. Enter amou worksheet	nt from	claim y No.	If single , en	nter \$7,700. enter \$13,850.		5		
,	_	(Q 1) VII - T (T 4 76 11 /	- · ·		r explanation.			7,700	00
	•	Subtract line 5 from This is your taxab		5 is larg	er than line 4	, enter -0	•	6	150	00
Payments and tax	_7	Federal income tax	withheld from b	oox 2 of	your W-2 for	m(s).		7	800	00
	_8	B Earned income cr	redit (EIC).					8	244	00
	_9	Add lines 7 and 8.	These are your t	otal pay	ments.		>	9	1,044	00
	10	Tax. Use the amou 24–28 of the book					ages	10	16	00
Refund	11	a If line 9 is larger t				•		11a	1,028	00
Have it directly deposited! See	•	b Routing number	2 5 0 2 5	00	25 ► c	Type: X Checkin	g Savings			
page 20 and fill in 11b, 11c, and 11d.	>	d Account number	20202	0 8	6					
Amount you owe	12	If line 10 is larger the amount you ov	,				•	12		
Third party		you want to allow an	other person to d	liscuss t		n the IRS (see page	, —	. Complete the	following.	☐ No
designee		signee's me ▶			Phone no. ► ()	Personal ider number (PIN)	ntification		
Sign here Joint return?	ac on	der penalties of perjury, I curately lists all amounts a all information of which t ur signature	and sources of incor	ne I recei	ved during the t	d to the best of my k ax year. Declaration of	nowledge and bel f preparer (other th	nan the taxpayer)	ect, and is based hone numbe	er
See page 11.	IV.	Iary Duvall			3/3/03	Cle	erk	()		
Keep a copy for your records.	Sp	ouse's signature. If a join	t return, both must	sign.	Date	Spouse's occupation	on			
Paid		eparer's VITA S	ite 123				Check if self-employed	Preparer's S	3N or PTIN	
preparer's	Fir	m's name (or					EIN	<u> </u>		
use only	ad	urs if self-employed), dress, and ZIP code					Phone no.	()		
For Disclosure	, Pr	ivacy Act, and Pape	rwork Reducti	on Act	Notice, see	page 23.	Cat. No. 11329W	7 Form	1040EZ	(2002)

Wage Earner Comprehensive Answers to Problems

Complete this form. Eligibility questions

Line 8 Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.



If you have a qualifying child (see the next column on this page), you may be able to take the credit, but you must use Schedule EIC and Form 1040A or 1040 to do so. For details, see Pub. 596.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet on page 19 or let the IRS figure the credit for you.

You Will Need:







If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1

All Filers

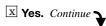
1. Is the amount on Form 1040EZ, line 4, less than \$11,060 (or \$12,060 if married filing jointly)?





You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 18)?

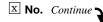




You cannot take the credit. Print "No" in the space to the left of line 8.

3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?





4. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

X Yes. Go to question 5. ☐ No. (STOP)

You cannot take the credit. Enter "No" in the space to the left of line 8.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 17 before you answer.

X Yes. Continue



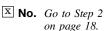
 \sqcup No. $^{ ext{(STOP)}}$

You cannot take the credit. Enter "No" in the space to the left of line 8.

6. Look at the qualifying child conditions below. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

(STOP) __ Yes.

You cannot take the credit. Enter "No" in the space to the left of





A qualifying child is a child who is—

Your son, daughter, adopted child, stepchild, or grandchild

Your brother, sister, stepbrother, stepsister or a descendant of

your brother, sister, etc. (for example, your niece or nephew)

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

was at the end of 2002...

Under age 19

or

Under age 24 and a student

or

Any age and permanently and totally disabled

who...

Either lived with you in the United States for more than half of 2002 or was born or died in 2002 and your home was the child's home for the entire time he or she was alive in 2002.

Note. Special rules apply if the child was married or also meets the conditions to be a qualifying child of another person (other than your spouse if filing a joint return). For details, use TeleTax topic 601 (see page 8) or see Pub. 596.

(Continued on page 18)

Complete this form.

Step 2 Earned Income	Definitions and Special Rules (listed in alphabetical order)
Figure earned income: Form 1040EZ, line 1 Subtract, if included on line 1, any: Taxable scholarship or fellowship grant not reported on a W-2 form Amount paid to an inmate in a penal institution for work (enter "PRI" in the space to the left of line 1 of Form 1040EZ). Amount received as a pension or annuity from a nonqualified deferred compensation plan or a section 457 plan (enter "DFC" in the space to the left of line 1 of Form 1040EZ). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity. Earned Income = Box	Definitions and Special Rules (listed in alphabetical order) Credit Figured by the IRS. To have the IRS figure the credit for you: 1. Enter "EIC" in the space to the left of line 8 of Form 1040EZ. 2. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862. Who Must File, below. Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year: • You filed Form 8862 (or other documents) and your EIC was then allowed and • Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error. Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud. Members of the Military. If you were on extended active duty outside the United States, your home is considered to be in the United States during that duty period. Extended active duty is military duty ordered for an indefinite period or for a period of more than 90 days. Once you begin serving extended active duty, you are considered to be on extended active duty even if you serve fewer than 90 days. Social Security Number (SSN). For purposes of taking the EIC, a valid SSN is a number issued by the Social Security Administration unless "Not Valid for Employment" is printed on the social security card and the number was issued solely to apply for or receive a Federally funded benefit. To find out how to get an SSN, see page 14. If you will not have an SSN by April 15, 2003, see What if You Cannot File on Time? on page 11. Welfare Benefits, Effect of Credit on. Any refund you receive as a result of taking the EIC will not be used to determine if you are eligible for the following programs, or how much you can receive from them. But if the refund you receive because the EIC is not spent within a certain period of time, it may count

Wage Earner Comprehensive Problems Answers to Problems

All Filers 1. Enter your total camed income from Step 2,	Earned Income C	Credit (EIC) Worksheet—Line 8 Keep for Your Records
Filers Who Answered "No" on Line 4 Yes. Leave line 5 blank; enter the amount from line 2 on line 6. \[\begin{align*} \text{X No.} \text{Look up the amount on line 3 in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here. \text{Look at the amounts on lines 5 and 2.} \text{Then, enter the smaller amount on line 6.} \[\text{Part 3} \] 6. This is your earned income credit. \[\text{If your EIC for a year after 1996 was reduced or disallowed, see} \] If your EIC for a year after 1996 was reduced or disallowed, see}		Box A, on page 18. 2. Look up the amount on line 1 above in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here. If line 2 is zero, You cannot take the credit. Enter "No" in the space to the left of line 8. 3. Enter the amount from Form 1040EZ, line 4. 3. Top Yes. Skip line 5; enter the amount from line 2 on line 6.
Your Earned Income Credit Enter this amount on Form 1040EZ, line 8. If your EIC for a year after 1996 was reduced or disallowed, see	Filers Who Answered "No" on	 Yes. Leave line 5 blank; enter the amount from line 2 on line 6. X No. Look up the amount on line 3 in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here. Look at the amounts on lines 5 and 2.
	Your Earned	Enter this amount on Form 1040EZ, line 8. If your EIC for a year after 1996 was reduced or disallowed, see

Problem 3

1040A	U.S. Individual Income T	ax Return (99) 20	02 IRS Use	Only—Do not write	or staple in this s	pace.
Label (Your first name and initial	Last name			MB No. 1545-0085	
(See page 19.) L	Albert W.	Rowan			00: 7698	
B	If a joint return, spouse's first name and initial	Last name			s social security nu	
Use the LIRS label.						
Otherwise E	Home address (number and street). If you have a 1515 Kingston Court	P.O. box, see page 20.	Apt. no	▲ Ir	nportant	
please print PE	City, town or post office, state, and ZIP code. If y	/ou have a foreign address, see page 20.			must enter yo	
	Charlotte, NC 28215				SSN(s) above.	
Presidential Election Campaign (See page 20.)	Note. Checking "Yes" will not chan Do you, or your spouse if filing a jo			You Yes	Spous ▼ No	_
Filing	1 Single		Head of househo			
status	2 Married filing jointly (even if or 3 Married filing separately. Enter		If the qualifying p enter this child's		ut not your deper	ndent,
Check only	3 Married filing separately. Enter full name here. ►		Qualifying wi		dependent ch	nild
one box.			(year spouse). (See page	
Exemptions	6a X Yourself. If your pare	nt (or someone else) can	claim you as a	1	No. of boxes checked on	1
	b Spouse	on his or her tax return,	uo not check t	ox ba.	6a and 6b No. of children	
	c Dependents:	(2) Dependent's social	3) Dependent's	(4) vif qualifying child for child	on 6c who:	
	(1) First name Last name	security number	relationship to you	tax credit (see	lived with you	_1
If more than six dependents,	Derek K Rowan	000:00:6568	grandson	page 23)	 did not live with you due 	
see page 22.	Derek K Rowali	000 00 0508	granusun		to divorce or separation	
					(see page 24)	
					Dependents on 6c not	
					entered above	
					Add numbers on lines	
	d Total number of exemption	ns claimed.			above	2
Income	7 Wages, salaries, tips, etc.	Attach Form(s) W-2		7	22,552	00
Attach	vvages, salaries, tips, etc.	88,008				
Form(s) W-2 here. Also		8a Taxable interest. Attach Schedule 1 if required. 8a				
attach	b Tax-exempt interest. Do not					
Form(s) 1099-R if tax	9 Ordinary dividends. Attach	Schedule 1 if required.		9		
was withheld.	10 Capital gain distributions	(see page 25).		10		
If you did not	11a IRA	· · · · · · · · · · · · · · · · · · ·	Taxable amou			
get a W-2, see page 25.	distributions. 11a		(see page 25			
Enclose, but do not attach, any payment.	12a Pensions and annuities. 12a	12b	(see page 26			
· -	13 Unemployment compensa	ation and Alaska Perman	ent Fund divide	ends. 13		
	14a Social security	14b				
	benefits. 14a		(see page 28). <u>14b</u>		
	15 Add lines 7 through 14b (fa	ar right column). This is yo	ur total income	. ▶ 15	22,552	00
Adjusted	16 Educator expenses (see pa	· /	6			
gross	17 IRA deduction (see page 2		7			
income	Student loan interest deductionTuition and fees deduction	, , , ,	8 a			
	20 Add lines 16 through 19.			20		L
	21 Subtract line 20 from line 1			▶ 21	22,552	00
	ZI Subtract line 20 from line i	o. Tillo lo your aujuoteu y	ji oss ii icoiiie.	P 21	88,008	00

Wage Earner Comprehensive Problems Answers to Problems

Form 1040A	(2002	2)			F	age 2
Tax,	22	Enter the amount from line 21 (adjusted gross income).		22	22,552	00
credits,				1		
and	23a	Check				
payments	b	(Depose was so of class		!		
Standard	ı b	deductions, see page 32 and check here				
Deduction for—	24	Enter your standard deduction (see left margin).		24	6,900	00
People who	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0		25	15,652	00
checked any box on line	26	Multiply \$3,000 by the total number of exemptions claimed on line 6d.		26	6,000	00
23a or 23b or who can be	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0			•	
claimed as a		This is your taxable income.		27	9,652	00
dependent, see page 33.	28	Tax, including any alternative minimum tax (see page 33).		28	968	00
All others:	29	Credit for child and dependent care expenses.	00			
Single, \$4,700		Attach Schedule 2. 29 345	00	-		
Head of	30	Credit for the elderly or the disabled. Attach Schedule 3.				
household, \$6,900	31	Schedule 3. 30 Education credits. Attach Form 8863. 31		-		
Married filing	32	Retirement savings contributions credit. Attach		-		
jointly or Qualifying	32	Form 8880. 32				
widow(er),	33	Child tax credit (see page 36). 33 600	00	-		
\$7,850 Married	34	Adoption credit. Attach Form 8839.		-		
filing	35	Add lines 29 through 34. These are your total credits.		35	945	00
separately, \$3,925	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0		36	23	00
(40,020	37	Advance earned income credit payments from Form(s) W-2.		37	360	00
	38	Add lines 36 and 37. This is your total tax.	•	38	383	00
	39	Federal income tax withheld from Forms W-2				
		and 1099. 39 1,850	00	-		
If you have	40	2002 estimated tax payments and amount applied from 2001 return. 40				
a qualifying	41	applied from 2001 return. 40 Earned income credit (EIC). 41 1,059	00	-		
child, attach Schedule	42	Additional child tax credit. Attach Form 8812.	-00	-		
EIC.	43	Add lines 39 through 42. These are your total payments.		43	2,909	00
Refund	44	If line 43 is more than line 38, subtract line 38 from line 43.			·	
		This is the amount you overpaid.		44	2,526	00
Direct deposit?	45a	Amount of line 44 you want refunded to you.	•	45a	2,526	00
See page 47 and fill in	▶ b	Routing number 3 2 0 3 6 0 0 3 6 ▶ c Type: ☒ Checking ☐ Savings				
45b, 45c, and 45d.	▶ d	1/1 () /1 () /2 () /7				
	46	Amount of line 44 you want applied to your		-		
	40	2003 estimated tax.				
Amount	47	Amount you owe. Subtract line 43 from line 38. For details on how		-		
you owe		to pay, see page 48.	_	47		
	48	Estimated tax penalty (see page 48). 48				
Third party		Do you want to allow another person to discuss this return with the IRS (see page 49)? \Box	Yes.	Complete	the following.	No
designee		Designee's Phone Persor name ▶ no. ▶ () numbe		ntification		
Sign		Under penalties of perjury, I declare that I have examined this return and accompanying schedules and sta	tement	ts, and to t	he best of my	
here		knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.		the tax yea	ar. Declaration	
Joint return?	k .	Your signature Date Your occupation		Daytin	ne phone numbe	er
See page 20.	1	Albert W. Rowan 1/24/2003 Security Officer		()	,,,,,,,,
Keep a copy for your		Spouse's signature. If a joint return, both must sign. Date Spouse's occupation				
records.	7			_ <i>\\\\\\\\</i>		
Paid		Preparer's VITA Site #500 Date 1/24/03 Check if self-employed	. —	Preparer	s SSN or PTIN	
preparer's	_	z, te z, e e generalizado	_Ц_	<u> </u>		
use only		Firm's name (or gill of the state of the sta		: .		
	-	address, and ZIP code Phone	по.	()	orm 10404	(2002)
		Printed on recycled paper			orm 1040A	(2002)

2002 Schedule 2

Schedule 2 Department of the Treasury-Internal Revenue Service Child and Dependent Care (Form 1040A) 2002 **Expenses for Form 1040A Filers** OMB No. 1545-0085 Your social security number Name(s) shown on Form 1040A Albert W. Rowan 000:00:7698 Before you begin: You need to understand the following terms. See Definitions on page 1 of the separate instructions. • Dependent Care Benefits • Qualifying Person(s) • Qualified Expenses Earned Income (a) Care provider's (b) Address (number, street, apt. no., (c) Identifying Part I number (SSN or EIN) city, state, and ZIP code) (see instructions) Maude Lee Child 551 Cower St Persons or 00 Care Center 1,500 organizations Charlotte, NC 28215 10-9963246 who provided the care (If you need more space, use the bottom of page 2.) You must complete this Complete only Part II below. Did vou receive part. dependent care benefits? Complete Part III on the back next. Caution. If the care was provided in your home, you may owe employment taxes. If you do, you must use Form 1040. See Schedule H and its instructions for details. Information about your qualifying person(s). If you have more than two qualifying persons, see Part II the instructions. (c) Qualified expenses Credit for child (a) Qualifying person's name (b) Qualifying person's social you incurred and paid and dependent security number in 2002 for the person First Last care expenses listed in column (a) Derek Rowan 000 00 6568 1,500 00 Add the amounts in column (c) of line 2. Do not enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. 00 1,500 If you completed Part III, enter the amount from line 26. 4 Enter your earned income. 22,552 00 5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); all 5 22,552 00 others, enter the amount from line 4. 6 Enter the smallest of line 3, 4, or 5. 6 1,500 00 Enter the amount from Form 1040A, line 22. 8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7. If line 7 is: If line 7 is: But not **Decimal Decimal** But not Over Over over amount is over amount is \$0-10,000 \$20,000-22,000 .24 10,000-12,000 .29 22,000-24,000 .23 12,000-14,000 .28 24,000-26,000 .22 14,000-16,000 .27 26,000-28,000 .21 16,000-18,000 .26 28,000-No limit .20 18,000-20,000 .25 8 \times . 23 9 Multiply line 6 by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions. 345 00 9 968 00 10 **10** Enter the amount from Form 1040A, line 28. Credit for child and dependent care expenses. Enter the smaller 00 345 of line 9 or line 10 here and on Form 1040A, line 29. For Paperwork Reduction Act Notice, see Form 1040A instructions. Cat. No. 10749I Schedule 2 (Form 1040A) 2002

Form 1040A Child Tax Credit Worksheet

Child Tax Credit	Worksheet—Line 33	Keep for Your Records					
Do not use this worksheet if you answered "Yes" to question 1 or 2 on page 38. Instead, use Pub. 972.							
	1. Number of qualifying children: $\phantom{aaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaaa$	1 600					
	2. Enter the amount from Form 1040A, line 28.						
	3. Add the amounts from Form 1040A: Line 29 345 Line 30 +	623					
	You may be able to take the additional child tax credit on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above. • First, complete your Form 1040A through line 41. • Then, use Form 8812 to figure any additional child tax credit.	Enter this amount on Form 1040A, line 33.					

Wage Earner Comprehensive Answers to Problems

Complete this form.

Form 1040A EIC Worksheet

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



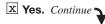
If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you

are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1

All Filers

- **1.** If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?





You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?





You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Is your filing status married filing separately?

☐ Yes. (STOP) You cannot take the credit.

🗵 No. Continue 🤰

4. Were you a nonresident alien for any part of 2002?

☐ **Yes.** See Nonresident 🗵 **No.** Go to Step 2. Aliens on page 44.

Step 2 **Investment Income**

Add the amounts from Form 1040A:

0 0 0 Line 9 0 Line 10 + 0 Investment Income =

2. Is your investment income more than \$2,550?

Yes. You cannot take the credit.

X No. Continue



3. Did a child live with you in 2002?

X Yes. Go to Step 3.

No. Go to Step 4 on page 42.

(Continued on page 42)

Wage Earner Comprehensive

PROBLEMS Answers to Problems

Complete this form Form 10/00 EIC Workshoot

Continued from page 41	FORM 1040A ETC WORKSHE			
Step 3 Qualifying Child A qualifying child is a child who is Your son, daughter, adopted child, stepchild, or grandchild	3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002? Yes. See Qualifying Child of More Than No. This child is your qualifying child. The child			
Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child or	One Person on must have a social security number as defined on page 44 unless the child was born and died in 2002. Skip Step 4; go to Step 5 on page 43.			
A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)	Step 4 Filers Without a Qualifying Child			
If the child was married, see page 42. AND	1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?			
was at the end of 2002 Under age 19 or	Yes. Stop You cannot take the credit. Put "No" to the left of the entry space for line 41.			
Under age 24 and a student (see page 44) or Any age and permanently and totally disabled (see page 44) AND	2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return? Yes. STOP You cannot take the credit.			
who Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.	Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002? Yes. Continue You cannot take the credit. Put "No" to the left of the entry space for line 41.			
Note. If the child was married, see page 44. 1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?	4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.			
You cannot take the credit. Put "No" to the left of the entry space for line 41.	☐ Yes. Go to Step 5 on page 43. ☐ No. STOP You cannot take the credit. Put "No" to the left of the entry space for line 41.			
2. Do you have at least one child who meets the above conditions to be your qualifying child? X Yes. Continue No. Skip question 3; go to				
▼ Yes. Continue	(Continued on page 41			

Complete this form.

Form 1040A EIC Worksheet

Continued from page 42						
Step 5 Earned Income	Step 6 How To Figure the Credit					
1. Figure earned income:	1. Do you want the IRS to figure the credit for you?					
Form 1040A, line 7 \$22,552	☐ Yes. See Credit					
Subtract, if included on line 7, any:	Figured by the IRS on page 44. below.					
 Taxable scholarship or fellowship grant not reported on a W-2 form 	<i>Delon.</i>					
 Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A) 	Definitions and Special Rules (listed in alphabetical order) Adopted Child. Any child placed with you by an					
Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457	authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.					
plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in	Credit Figured by the IRS. To have the IRS figure the credit for you:					
box 11 of your W-2 form. If you received such an amount but box	1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.					
11 is blank, contact your employer for the amount received as a pension or annuity.	 If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, 					
Taxable Earned Income = \$22,552	on page 44.					
Go to Step 6.	Exception to "Time Lived With You" Condition. A					
2. If you have:	child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this					
• 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?	child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.					
• 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?						
• No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?						
▼ Yes. Go to Step 6. □ No. STOP						
You cannot take the credit.	Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:					
	 You filed Form 8862 (or other documents) and your EIC was then allowed and 					
	 Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error. 					
	Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.					

WAGE EARNER COMPREHENSIVE PROBLEMS Answers to Problems

2002 EIC Worksheet

Earned Income (Credit (EIC) Worksheet—Line 41 Keep for Your Records
Part 1 All Filers	1. Enter your earned income from Step 5, on page 43.
	2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.
	If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41.
	3. Enter the amount from Form 1040A, line 22. 22,552
	4. Are the amounts on lines 3 and 1 the same?
	x Yes. Skip line 5; enter the amount from line 2 on line 6. ☐ No. Go to line 5.
Part 2 Filers Who Answered "No" on Line 4	 5. If you have: No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)? 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)? Yes. Leave line 5 blank; enter the amount from line 2 on line 6. No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct
	column for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6.
Part 3	6. This is your earned income credit. 6 1,059
Your Earned Income Credit	Reminder— √ If you have a qualifying child, complete and attach Schedule EIC. Enter this amount on Form 1040A, line 41. 1040A Elect this amount on Form 1040A, line 41.
	If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

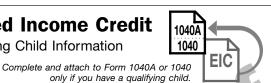
Wage Earner Comprehensive PROBLEMS Answers to Problems

2001 Schedule EIC

SCHEDULE EIC (Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

Department of the Treasury Internal Revenue Service

Name(s) shown on return

Albert W. Rowan

Your social security number

000 00 7698

Before you begin:

See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.

• If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up



- to 10 years. See back of schedule for details. It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Q	ualifying Child Information	0	Child 1	Child 2		
1	Child's name If you have more than two qualifying children, you only have to list two to get the maximum credit.	First name Derek K. I	Last name	First name	Last name	
	Child's SSN The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate. Child's year of birth	000 Year <u>1</u>	00 6568 9 9 4	Year		
		If born after and 4b; go	r 1983, skip lines 4a to line 5.	If born after 19 and 4b; go to 1	983, skip lines 4a line 5.	
-	If the child was born before 1984— Was the child under age 24 at the end of 2002 and a student?	Yes. Go to line 5	No. Continue	Yes. Go to line 5.	No. Continue	
k	Was the child permanently and totally disabled during any part of 2002?	Yes.	No. The child is not a qualifying child.	Yes. Continue	No. The child is not a qualifying child.	
5	Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)	G	randson			
6	Number of months child lived with you in the United States during 2002					
	• If the child lived with you for more than half of 2002 but less than 7 months, enter "7".		12 months		montho	
	• If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12".	Do not ente	r more than 12 months.	Do not enter more than 12 months.		

CW-34 Comprehensive

WAGE EARNER

or 1040 instructions.

For Paperwork Reduction Act Notice, see Form 1040A

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2002

SALE OF STOCK

Lesson 12

OBJECTIVES

After completing this lesson you should be able to:

- Identify the items that affect the basis of a stock.
- Determine if a stock's holding period is long term or short term.
- Determine when and how to report commissions from sale of stock on Schedule D.
- Calculate the amount of the qualified 5-year gain.
- Calculate the taxable gain or deductible loss using Schedule D.
- Calculate the tax liability using Part IV of Schedule D.
- Calculate the amount of capital loss carryover using the capital loss carryover worksheet.

What You Will Need

In order for you to complete Schedule D, the taxpayer will need to show you his or her records, including information returns he or she receives that are also forwarded to IRS.

- Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*, which the broker gives the taxpayer to report the sale price of stock.
- The taxpayer's records of his or her basis in the stock sold. Basis is explained in this lesson.
- The taxpayer's records of the date he or she originally acquired the stock.
- Form 1099-DIV, *Dividends and Distributions*, if the taxpayer received capital gain distributions (for example, from a mutual fund).
- The taxpayer's *Capital Loss Carryover Worksheet* from last year's Schedule D instructions if the taxpayer is carrying over a loss to 2002.

The taxpayer should not file these items with the return, but keep them with his or her records. The Internal Revenue Service (IRS) already receives copies of Form 1099-B from the broker and copies of Form 1099-DIV from the payer.

TAX TIPS

***** If the taxpaver elected to recognize gain on an asset held on January 1, 2002 his or her basis in the asset is its closing market price or fair market value whichever applies, on the date of the deemed sale whether the deemed sale resulted in a gain or an unallowed loss. **Taxpayers** in this situation should use a paid professional preparer.

ALERT



Reporting capital gain distributions is simplified for 2002. Schedule D generally is not needed for taxpayers who received capital gain distributions from mutual funds but did not sell anv shares of stock and do not have any Forms 1099-B as explained in Lesson 3. Income. Instead, report the total capital gain distribution on Form 1040, line 13, or on Form 1040A, line 10. If the taxpayer must file Form 1040, remember to check the box next to line 13 of Form 1040 to indicate that Schedule D is not required. If the taxpayer sold stocks, he or she must file Form 1040 and cannot report capital gain distributions on Form 1040A.

Capital Asset

A **capital asset** is any asset held either for personal use or for investment. Thus, all your items of personal property, such as your home and car, are capital assets. Property held for investment includes stocks and bonds. Property used in a trade or business, such as inventory or machinery, is not a capital asset.

In this lesson, corporate stock is the only capital asset discussed. **Capital gain distributions** are also discussed. They are recognized when the entity (such as a mutual fund) that owned a capital asset disposes of it and passes gain through to its shareholders. The discussion of capital gain distributions in this lesson supplements what you previously learned in Lesson 3.

Basis

The **basis** of property is usually its cost. Certain additional costs relating to its purchase are included in the basis of a capital asset. An example of an expense to include in the basis of stock is the commission or fee paid to a broker when stock is purchased.

If the taxpayer is not able to provide his or her basis in the property, the IRS will deem it to be zero. The taxpayer should make every effort to determine the basis. Refer taxpayers to their stockbroker or financial planner for assistance in determining basis. Once the taxpayer has the basis, volunteers may assist in preparing the tax return.

Adjusted Basis

Events after purchase can require adjustments to the basis of stock. The term **adjusted basis** refers to the basis after changes are made. For example, when a stock dividend or stock split is declared, the stockholder receives additional shares of stock. Some of the basis from the original stock is then allocated to the new stock. This change reduces the basis per share of the original shares.

Example 1

Fran paid \$1,100 for 100 shares of ABC, Inc. stock (including the broker's commission of \$25). Fran received 10 additional shares of ABC stock as a tax-free stock dividend. Her \$1,100 basis must be spread over 110 shares (100 original shares plus the 10-share stock dividend). Her basis per share decreases from \$11 to \$10 per share.

Holding Period

Long-term or short-term. Capital gains and losses are classified as either "long-term" or "short-term," depending on how long the taxpayer owned the stock. Stock held for more than one year (12 months) has a long-term holding period. Stock held for one year or less has a short-term holding period.

Example 2

Loretta bought stock on January 11, 2001 (trade date). Her holding period began the next day, January 12. If she sells that stock on January 11, 2002, she will not have owned them for more than a year. The holding period will be short-term. However, if she sells the stock on January 12, 2002, or later, the holding period will be long-term.

Blocks. Frequently, a taxpayer owns shares of stock that were bought on different dates or for different prices. That is, the individual owns more than one block of stock. Each block may differ from the others in its holding period (long-term or short-term), its basis (amount paid for the stock), or both.

In directing a broker to sell stock, the taxpayer may specify which block, or part of a block, to sell. Specification can make a difference in determining the holding period or basis of the stock sold, giving the taxpayer an element of control and versatility in handling an investment. To be valid, any such specification must be made before or at the time of sale. It cannot be made after the sale. If the taxpayer does not identify the specific block at the time of sale, shares sold are treated as coming from the earliest block purchased.

TAX TIPS

The adjusted basis
of a stock is usually
its cost plus any brokers' commissions.
If you are not
certain, ask the
taxpayer about any
commissions on the
purchase.

TAX TIPS

To find out how long the taxpayer has held the stocks, begin counting on the day after the day he or she bought the shares of stock and include the day the shares are sold. This sale trade date is part of the holding period.

POTENTIAL PITFALLS



Stock splits and stock dividends do not occur often. However, do not assume that they never happen. Ask taxpayers if they received any additional shares from a stock split or stock dividend.

POTENTIAL PITFALLS



The specific selection of the block of stock must be made when the broker is directed to sell the stock, not after the fact.

POTENTIAL PITFALLS



Shares from a stock dividend may or may not have the same holding period as the original shares.

Example 3

In 1996, Tina bought 100 shares of Acme Corporation stock for \$2,000. In 1997 she bought another 100 shares of Acme for \$2,300. In 2002, Tina sold 100 shares of Acme for \$3,000.

The adjusted basis of the shares sold is \$2,000. However, if Tina had told her broker to sell the 100 shares bought in 1997, the adjusted basis of the shares sold would have been \$2,300, reducing her profit (and any taxable amount) on the sale.

Tax-free stock dividends and stock splits. Stock acquired in a tax-free stock dividend or stock split has the same holding period as the original stock owned. Thus, if the original stock has a long-term holding period, stock received in a tax-free stock dividend also has a long-term holding period. Similarly, if the original stock has a holding period of three months, the new stock immediately has a three-month holding period.

Example 4

On February 18, 1999, Wallace bought 500 shares of XYZ Corporation stock for \$1,500, including his broker's commission. XYZ distributed a two-percent stock dividend on April 6, 2002. On April 9, 2002, Wallace sold all his XYZ stock for \$2,030. He has a long-term capital gain of \$530 on the sale of his stock. Although he owned the 10 shares he received as a tax-free stock dividend for only three days, all the stock has a long-term holding period.

Taxable dividends. There are several types of taxable dividends, as discussed in Lesson 3. A taxpayer who participates in a dividend reinvestment plan (one type of taxable dividend) will use the dividends to purchase more shares of the stock. The stocks acquired (including fractional shares) through the dividend reinvestment plan are added to the taxpayer's basis at fair market value on the date of distribution. Thus, the new shares of stock do not always have the same holding period as the original stock. If the taxpayer does not know their basis refer them to their stockbroker or financial planner.

Demutualization

Some taxpayers have been informed by their insurance company that the company has been demutualized. When this happens the policy holder receives either a block of stock or the cash equivalent of company stock. The holding period for such stock is the length of time the policy has been in effect, usually many years. The basis for this stock is zero. The taxpayer must report all of the proceeds as a capital gain, usually long term. This gain will qualify for the qualified 5-year gain rate if the policy was held for more than 5 years.

Wash Sales

Generally, a **wash sale** occurs when stock is sold and, within 30 days before or after the sale, substantially identical stock is bought. A loss on a wash sale is not deductible, and special rules relate to the basis of the replacement stock. However, a gain on a wash sale must be reported. Any taxpayer with a wash sale should be referred to a paid professional tax preparer.

Sales Price, Form 1099-B, and Adjusted Basis

The stockbroker reports **sales price** to the Internal Revenue Service in box 2 of Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions* (see Exhibit 1). Some brokers do not subtract commissions and fees; they report the **gross proceeds** as the sales price. Other brokers do subtract commissions and fees, reporting the **gross proceeds less commissions** (referred to as *net proceeds* in this lesson) as the sales price. The broker checks the appropriate square at the right of box 2 to indicate whether the gross or net proceeds were reported to IRS.

If Form 1099-B reports gross proceeds, add the sales broker's commissions and fees to the basis. If Form 1099-B reports net proceeds, the broker already subtracted the commissions and fees the seller paid. Do not adjust the basis further.

Exhibit 1 Form 1099-B

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1a Date of sale	OMB No. 1545-0715	Proceeds From Broker and		
	1b CUSIP no.	Form 1099-B	Barter Exchange Transactions		
	2 Stocks, bonds, etc.	Reported Gross proceeds to IRS Gross proceeds less	commissions and option premiums		
PAYER'S Federal identification number RECIPIENT'S identification number	3 Bartering \$	4 Federal income tax withheld \$	Copy B For Recipient		
RECIPIENT'S name	5 Description		This is important tax information and is being furnished to the		
	Regulated Fu	itures Contracts	Internal Revenue		
Street address (including apt. no.)	6 Profit or (loss) realized in 2002	7 Unrealized profit or (loss) or open contracts-12/31/2001	Service. If you are required to file a return, a negligence penalty or		
City, state, and ZIP code	\$	\$	other sanction may be imposed on you if this		
Account number (optional)	8 Unrealized profit or (loss) on open contracts-12/31/2002	9 Aggregate profit or (loss)	income is taxable and the IRS determines that		
	\$	\$	it has not been reported.		

Example 5

George sold stock for \$2,300. He paid his broker a commission of \$35 on the sale and received net proceeds of \$2,265. If his broker reported the gross proceeds, box 2 of Form 1099-B would show \$2,300, and the box next to gross proceeds would be checked. If his broker reported the net proceeds, box 2 of Form 1099-B would show \$2,265, and the box next to gross proceeds less commissions would be checked.

As a general rule, you will need the following information from Form 1099-B:

Information You Will Need From Form 1099-B								
IF Form 1099-B shows information in:	THEN report it on:							
Box 1a, Date of sale	Schedule D, column (c), of either Part I, line 1, or Part II, line 8							
Box 2, Sales price reported to Internal Revenue Service (whether gross or net proceeds were reported)	Schedule D, column (d), of either Part I, line 1, or Part II, line 8							
Box 4, Federal income tax withheld	Form 1040, line 59							
Box 5, Description of the property sold	Schedule D, column (a) in either Part I, line 1, or Part II, line 8							

If there are entries in box 3 or in boxes 6 through 9 of Form 1099-B, refer the taxpayer to a paid professional tax preparer.

Form 1099-B does **not** include the date the taxpayer bought the stock or what he or she paid for it. The taxpayer will need to provide you with this information.

Some brokers do not issue Forms 1099-B. Instead they issue a statement, sometimes titled "A 1099 Consolidated Statement," which shows stock sales and other types of distributions such as dividends and interest. Exhibit 2 is an example of such a statement.

Exhibit 2 A 1099 Consolidated Statement

Exhibit 2												A 1099 Co	onsolidated S	tatemen
	\$2,000	1099-R Distribu Gross distribution (Box 1)	Totals	145367 239863	Reference number	1099-B Proceed	Box 35	Investment expenses	Box 1 \$559.00	1099-DIV Divi Ordinary dividends	Box 1 \$378.00	1099-INT Interest Income 2002 Interest income not Early with included in box 3 penalty	KING INVESTMENTS 555 CENTER STREET NEW YORK, NY 10022	Payer
	\$2,000	1099-R Distributions from IRAs 2002GrossTaxableTadistributionamountan(Box 1)(Box 2a)det		7/17/02 10/23/02	Trade date (Box 1a)	1099-B Proceeds from Broker and Barter Exchange Transactions 2002	Box 6 \$25.00	Foreign tax paid	Box 2a \$179.00	Dividends & Distributions 2002 Capital gain 28% rate distributions	Box 2	st Income 2002 not Early withdrawal penalty	MENTS TREET Y 10022	
		Taxable amount not determined		765298 927651	CUSIP number (Box 1b)	Barter Exchange	Box 7	Foreign country or US possession	Box 2b	tions 2002 28% rate gain	Box 3 \$100.00	wal US Savings Bonds and other US Treasury interest	Paul Susa 123 (Clar	Ассо
		(Box 2b) Total Distribution		200 shrs ABC Corp. 300 shrs XYZ Markets, Inc.	Quantity Description (Box 5)	Transactions 200	Box 8		Box 2c	Unrecaptured sec. 1250 gain	00.00 Box 4	onds	Paul J. Birch Susan L. Birch 123 Green Street Claremont, VA 91711	Account Number 7764366
	\$0.00	Federal Income tax withheld (Box 4)		orp. arkets, Inc.	ion (Box 5)	02	x 8	Liquidation distributions—cash	Box 2d	Section 1202 gain		tax withheld		
	7-Normal Distribution	Distribution Code (Box 7)		\$16.75 \$83.65	Price		Box 9	Liquidation distributions—n	Box 3	Nontaxable distributions	Box 5	Foreign tax paid		SS# 000-00-7026
	bution Yes	IRA/SEP/SIMPLE	\$28,300.10	\$3,299.90 \$25,000.20	Gross proceeds less commissions (Box 2)			-non-cash	Box 4	Federal income tax withheld	Box 6	Foreign country or US possession		
		IMPLE			Federal income tax withheld (Box 4)							ī.		

Qualified 5-Year Gain

Qualified 5-year gain is a long-term capital gain from the sale of property held for more than 5 years. This qualified 5-year gain is taxed at 8% to the extent the gain would otherwise be taxed at 10%. The 8% tax rate does not apply to collectibles gain, gain on qualified small business stock, or unrecaptured section 1250 gain. The Qualified 5-Year Gain Worksheet – Line 29, Schedule D Instructions, must be completed to determine which gains are subject to the 8% tax rate. Schedule D, Part IV, includes the tax computation for the maximum capital gain rates.

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For the following situations, determine the adjusted basis of the stock sold, whether the holding period is long-term or short-term, and how the sales price is reported.

- **A.** On May 11, 2000, Morris bought 1,000 shares of ZZZ Corporation stock for \$5,000, plus a \$100 commission. On February 14, 2002, he sold 500 shares for \$3,300 and paid a \$45 commission. The broker reported net proceeds on the sale.
 - **1.** What is the adjusted basis of the stock sold? ______
 - 2. Is the holding period long term or short term?_____
 - **3.** What amount is reported to the Internal Revenue Service in box 2 of Form 1099-B?____
- **B.** In the case of Morris, above, assume that he bought 500 more shares of ZZZ stock on October 6, 2001, for \$3,500, plus a \$50 commission. At the time of the sale, he told the broker to sell the stock he had bought in 2001.
 - **1.** What is the adjusted basis of the stock sold? _____
 - **2.** Is the holding period long term or short term?_____

C.	On November 30, 2000, Janice bought 100 shares of ABC Corporation stock for \$9,965, plus a \$35 commission. On January 5, 2002, the stock split two-for-one, and she then held a total of 200 shares. On March 6, 2002, she sold 100 shares for \$6,470 and paid a \$30 commission. Her broker reported net proceeds.
	1. What is the adjusted basis of the stock sold?
	2. Is the holding period long term or short term?
	3. What amount is reported to the Internal Revenue Service in box 2 of Form 1099-B?

Reporting Gain or Loss on Schedule D

Use Schedule D (Form 1040), *Capital Gains and Losses*, to report gain or loss on the sale of stock. Figure gain or loss by subtracting the adjusted basis of stock sold from its sales price. If the sales price is greater, the taxpayer has gain on the sale. By contrast, if the adjusted basis is greater than the sales price, the taxpayer has a loss on the sale. To denote a loss, place the number in parentheses. The taxpayer should receive Form 1099-B, reporting each sale of stock.

Also use Schedule D to report capital gain distributions that the taxpayer has in addition to any sales of stock. Enter the capital gain distributions on Schedule D, Part II, line 13. They are reported to the taxpayer on Form 1099-DIV, *Dividends and Distributions*, box 2a.

Any distributions that are qualified 5-year gain will be reported to the taxpayer in box 2c and used to complete the Qualified 5-year gain Worksheet in the Schedule D instructions.

If the taxpayer had capital gain distributions, but did not sell stock, he or she may not have to use Schedule D. Instead, report the capital gain distributions as explained in Lesson 3, *Income*.

Schedule D is divided into four parts. They are:

- Part I, *Short-Term Capital Gains and Losses*. For assets held one year or less.
- Part II, *Long-Term Capital Gains and Losses*. For assets held more than one year. Part II shows all long-term gains and losses and identifies the part subject to the 28% tax rate. The 28% rate applies to section 1202 gain from the sale or exchange of qualified small business stock and to collectibles.

TAX TIPS

Schedule D (Form
1040) is included in
the Tax Forms
Booklet Appendix.

- Part III, *Taxable Gain or Deductible Loss*.
- Part IV, *Tax Computation Using Maximum Capital Gains Rates*. You should have no trouble with Part IV if you take your time and do as the form says for each line. Using Part IV, rather than the Tax Table or Tax Rate Schedules, may result in lower tax.

Parts I and II: Short-Term and Long-Term Capital Gains and Losses

Report transactions in Parts I and II as follows:

To Report Capital Gain or Loss in Part I or II, Schedule D								
	Short-Term	Long-Term						
Show the first four sales on:	Part I, Line 1, Schedule D	Part II, line 8, Schedule D						
For additional sales, use:	Part I, line 1, Schedule D-1	Part II, line 8, Schedule D-1						
And transfer the total additional sales amount:	From Part I, line 2, Schedule D-1	From Part II, line 9, Scheduled D-1						
	Onto Part I, line 2, Schedule D	Onto Part II, line 9, Schedule D						

Add the sales price amounts in column (d), lines 1 and 2 of Part I. Enter the result on line 3. Then add the amounts in column (d), lines 8 and 9 of Part II. Enter the result on line 10. The total of line 3 plus line 10 must equal the total from box 2 of all the taxpayer's Forms 1099-B. If they do not agree, the taxpayer should attach a statement to the return to explain the difference.

The Internal Revenue Service will compare the amounts reported on all of a taxpayer's Forms 1099-B with the sum of the amounts reported on lines 3 and 10 of Schedule D. If the numbers do not agree and the taxpayer did not explain the difference, IRS will contact the taxpayer.

Example 6

On November 13, 2001, Mary Lou bought 500 shares of XEN, Inc. stock for \$20 a share (\$10,000 total), plus a \$50 commission. On February 26, 2002, she sold the stock for \$8,090 and paid selling expenses of \$40. The Form 1099-B from her broker reported a sales price of \$8,090 (gross proceeds). Part I of Mary Lou's completed Schedule D appears in Exhibit 3.

Mary Lou has a short-term capital loss. Notice that Mary Lou shows the loss in column (f) of line 1. She completes Part I by entering the net short-term loss on line 7. This example shows that:

- Her broker reported gross proceeds on Form 1099-B. The amount shown in column (d) is \$8,090 (because selling expenses have not been subtracted), and
- She works those expenses into the computation—as an adjustment to basis, column (e)—and the result in column (f) reflects her true gain or loss.

Exhibit 3	Mary Lou's Schedule D, Part I

Рa	rt I Short-Term Ca	pital Gains a	nd Losses-	-Assets Held O	ne Year or Les	SS			
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other ba (see page D-5 of the instructions)				
1									
	500 sh. XEN	11/13/01	2/26/02	8,090 00	10,090 0	0 (2,000 00)			
				10					
2	Enter your short-term Schedule D-1, line 2.								
3	Total short-term sale Add lines 1 and 2 in colu	es price am	nounts.	8,090 00					
4	Short-term gain from For 6781, and 8824		hort-term gair						
5									
6	Short-term capital loss of 2000 Capital Loss Carryo	carryover. Ente	er the amount	, if any, from line	8 of your	()			
7	Net short-term capital	gain or (loss).	Combine line	s 1 through 6 in c	olumn (f).	(2,000 00)			

Example 7

Exhibit 4 shows the three long-term transactions that Tess is reporting on Schedule D, Part II, for 2002. On August 21, 1999, she bought 200 shares of XYZ Company for \$1,500. On October 1, 2000, she bought 500 shares of TUV, Inc., for \$8,000, and on November 18, 2000, she bought 2,000 shares of QRS, Inc., for \$5,000. Each amount includes the commission.

On January 10, 2002, Tess sold the stock in XYZ and TUV. The Form 1099-B from her broker reported gross proceeds of \$1,875 for the XYZ stock, and \$6,000 for TUV. Tess paid commissions of \$35 for selling the XYZ shares, and \$40 for selling TUV. On March 27, 2002, Tess sold the QRS stock for \$10,000. She paid a \$50 commission. Her broker reported net proceeds of \$9,950 on Form 1099-B.

This example shows how to:

- Report basis when Form 1099-B shows gross proceeds (XYZ and TUV—basis includes commissions on the sale, as well as prior adjusted basis), in contrast to when it shows net proceeds (QRS—basis does not include commissions on the sale, but only the prior adjusted basis).
- Net gains and losses in column (f).

Exhibit 4 Tess' Schedule D, Part II

Pa	rt II Long-Term Cap	oital Gains a	nd Losses—	Assets He	ld M	ore Than O	ne Y	ear		
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales p (see page D the instruct	-5 of	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (Subtract (e) fr		(g) 28% rate gain or (loss) * (see instr. below)
8	200 sh. XYZ	8/21/99	1/10/02	1,875	00	1,535	00	340	00	
	500 sh. TUV	10/1/00	1/10/02	6,000	00	8,040	00	(2,040	00)	
	2,000 sh. QRS	11/18/00	3/27/02	9,950	00	5,000	00	4,950	00	
						· · · · · · · · · · · · · · · · · · ·				
9	Enter your long-term Schedule D-1, line 9.	,	· ·		1					
10	Total long-term sale Add lines 8 and 9 in colu	-		17,825	00					
11	Gain from Form 4797, Flong-term gain or (loss) f		•				11			
12	Net long-term gain or (lo	ss) from partne			tates,	and trusts	12		!	
13	Capital gain distributions	s. See page D-	1 of the instru	ctions .			13		!	
14	Long-term capital loss c any, from line 13 of your						14	()	()
15	Combine lines 8 through	14 in column	(g)				15			
16	Net long-term capital g		Combine lines	s 8 through	14 in	column (f)	16	3,250	00	

^{*28%} rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11338H

Schedule D (Form 1040) 2002

Exercise 2

For each of the following situations, figure the gain or loss on the sale of stock and indicate whether the gain or loss will be long term or short term.

A. On March 15, 2001, Bill bought 1,000 shares of stock for \$15,000, including commission. On March 15, 2002, he sold 600 shares of the stock for \$7,800, net proceeds on Form 1099-B.

1. Will Bill report a gain or a loss?

2. How much is the gain or loss?_____

3. Is the holding period long term or short term? _____

B. On January 7, 2001, Margo bought stock for \$1,500, plus a \$25 commission. On July 15, 2002, she sold the stock for \$2,000 and paid a \$25 commission. Her Form 1099-B shows the gross proceeds of \$2,000 as the sales price.

1. Will Margo report a gain or a loss?_____

2. How much is the gain or loss?

3. Is the holding period long term or short term? _____

Reporting Capital Gain Distributions From Form 1099-DIV on Schedule D

If the taxpayer received Form 1099-DIV, *Dividends and Distributions*, see whether an amount is shown in box 2a and box 2c.

- If capital gain distributions from Form 1099-DIV are the only capital gains or losses the taxpayer had for the year, the taxpayer may be able to report them directly on Form 1040A or Form 1040, as explained in Lesson 3, *Income*.
- If the taxpayer also sold stock reported on Form 1099-B, report the total capital gain distributions from Form 1099-DIV on line 13, column (f), of Schedule D.

Example 8

Alec received a Form 1099-DIV. Box 2a shows he received a total capital gain distribution of \$170. Alec also received a Form 1099-B that shows a net sales price of \$1,200 on the sale of 600 shares of ABC Group, Inc. He bought the stock on February 19, 2000, and sold it on August 25, 2002. His basis in ABC, including commission, is \$1,455. Alec's Form 1099-DIV, and Part II of his Schedule D, are shown in Exhibits 5 and 6. In this example, the capital gain distribution must be shown on Schedule D because Alec also sold stock in 2002 that must be reported on Schedule D.

Exhibit 5 Alec's Form 1099-DIV

PAYER'S name, street address, city,	state, ZIP code, and telephone no.	1	Ordinary dividends	OMB No. 1545-0110		
MIG, INC.		\$				
4321 Main Street		2a	Total capital gain distr.	മെനാ		Dividends and
Anytown, VA 00012		\$	170.	2002		Distributions
		2b	28% rate gain			
		\$		Form 1099-DIV		
PAYER'S Federal identification number	RECIPIENT'S identification number	2c	Qualified 5-year gain	2d Unrecap. sec. 125	0 gain	Сору В
00 - 0000123	000 - 00 - 0128	\$		\$		For Recipient
RECIPIENT'S name		2e	Section 1202 gain	3 Nontaxable distrib	utions	This is important tax
Alec Green						information and is
		\$		\$		being furnished to the Internal Revenue
Street address (including apt. no.)		4	Federal income tax withheld	5 Investment expens	ses	Service. If you are required to file a return,
1234 A Street		\$		\$		a negligence penalty or
City, state, and ZIP code		6	Foreign tax paid	7 Foreign country or U.S.	possession	other sanction may be imposed on you if this
Anytown, VA	00013	\$				income is taxable and
Account number (optional)		8	Cash liquidation distr.	9 Noncash liquidation	distr.	the IRS determines that it has not been
		\$		\$		reported.

Exhibit 6 Alec's Schedule D, Part II

acquired (Mo., day, yr.)	(c) Date s Mo., day, 3/25/	yr.)	(d) Sales pri (see page D- the instruction	5 of ons)	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (le Subtract (e) fro		(g) 28% rate g (loss) (see instr. be	*
2/19/00 8	3/25/	02	1,200	00						
.,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	7,1007			00	1,455	00	(255	00)		
			,		1,100		(200			
						1 1 1 1 1 1 1				
totals, if any, t		9								
es price amou umn (d)		10	1,200	00						
Part I; long-term from Forms 4684,	_					11				
ss) from partnersh						12				
s. See page D-1 o	of the in	nstrud	ctions .			13	170	00		
arryover. Enter in 2001 Capital Los			()		,	14	()	()
14 in column (g)						15			,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	
gain or (loss). Co ne back.	ombine	lines	8 through 1	4 in	column (f)	16	(85	00		
1 3a ne	4 in column (g) in or (loss). Co	4 in column (g) in or (loss). Combine back.	4 in column (g)	4 in column (g)	4 in column (g)	4 in column (g)	4 in column (g)	4 in column (g)	4 in column (g)	4 in column (g)

After Completing Parts I and II of Schedule D

Double-check your entries on Schedule D up to this point.

- Check that the sales price amount from each Form 1099-B agrees with the amount entered in column (d) of either line 1 or line 8.
- Check that all entries in column (d), lines 1 and 2, add up to the amount on line 3.
- Check that all entries in column (d), lines 8 and 9, add up to the amount on line 10.
- Check that line 3, added to line 10, agrees with the total sales price reported on all of the taxpayer's Forms 1099-B.
- Check that the amount on line 13, column (f), is the same as the total from all the taxpayer's Forms 1099-DIV, box 2a.

PENSION EARNER

Exercise 3

This exercise will give you practice with Schedule D. Use the following information to complete Parts I and II of Jane's Schedule D.

Jane sold five stocks during 2002. Her broker reported net proceeds as sales price.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
500 sh LSR	1/12/01	1/4/02	\$ 4,000	\$ 9,000
250 sh BGI	3/11/01	2/12/02	10,000	2,500
75 sh ABC	1/22/01	1/29/02	2,000	7,500
400 sh XYZ	12/3/99	3/6/02	15,000	10,000
100 sh DEF	4/2/99	1/16/02	1,200	2,000

Jane also owns shares in a mutual fund that sent her a Form 1099-DIV. It reported \$1,200 paid to her in total capital gain distributions for the year.

Exhibit 7

Complete Parts I and II of Jane's Schedule D.

Pa	rt I S	hort-Term Ca	pital Gains a	ind Losse	s—A	ssets Held	O b	ne Year or	Less		
		tion of property 00 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date so (Mo., day,)		(d) Sales prio (see page D-5 the instruction	of	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (loss) Subtract (e) from (
1											
							1				
									V		
2		our short-term e D-1, line 2 .	totals, if an	y, from	2						
3		short-term sales	es price an	nounts.	3						
4		rm gain from Fo	. ,			or (loss) from			4		
5	Net shor	t-term gain or (lo	oss) from partn		orpor	ations, esta			5		
6	Short-te	rm capital loss	carryover. Ent	er the amo	unt, if	f any, from			6	()
7		pital Loss Carry							7		`
-		ong-Term Car								ear	
ı G			(b) Date	(c) Date so		(d) Sales pric		(e) Cost or other			(g) 28% rate gair
		tion of property 00 sh. XYZ Co.)	acquired (Mo., day, yr.)	(Mo., day, y		(see page D-5 the instruction	of	(see page D-5 instruction	of the	(f) Gain or (loss) Subtract (e) from ((1000) *
8			, , ,,,,,			- :			i –		
9	Enter y	our long-term	totals, if any	y, from							
	Schedule	e D-1, line 9 .			9						
10	Add line	ong-term sales s 8 and 9 in colu	umn (d)	L	10						
11		m Form 4797, F m gain or (loss) f							11		
12	-	-term gain or (lo hedule(s) K-1.		•	orpor	ations, esta	tes,	and trusts	12		
13	Capital o	gain distributions	s. See page D-	-1 of the ins	structi	ions			13		
14	J	rm capital loss c n line 13 of your	,			()		,	14	() (
15	•	e lines 8 through	·	·			•		15		
16	Net long	g-term capital on the	gain or (loss).	(0)	ines 8	3 through 14	4 in	column (f)	16		
* 28	% rate ga		des all "collect	tibles gains	and I	osses" (as o	defin	ned on page	D-6 o	f the instruction	s) and up to 50%
		Reduction Act N								Sahadul	le D (Form 1040) 2
UI	r aperwork	. neuucuun ACL N	iouce, see for	น เบษบ แเรเก	uction	13.		Cat. No. 11338F	1	Scriedul	2 (COIII 1040) كا ت

Part III: Summary of Parts I and II

Combine the amounts from line 7 (net short-term capital gain or loss) and line 16 (net long-term capital gain or loss). Enter the result on line 17 in Part III. This combined number may be a gain or a loss.

- If the line 17 amount is a gain, also enter it on line 13 of Form 1040.
- If the line 17 amount is a loss, complete line 18 of Schedule D. Line 18 ensures that no more than the maximum allowable capital loss is deducted on Form 1040. The line 18 amount is limited to the smaller of:
- The loss from line 17 or
- \$3,000 (\$1,500 for a married taxpayer filing separately).

Also enter this amount on line 13 of Form 1040. Because it is a loss, be sure to put parentheses around the number when you enter it on Form 1040; you will not need Part IV of Schedule D.

Part IV: Tax Computation Using the Maximum Capital Gains Rates

The law limits tax rates on net long-term capital gains. To obtain the lowest rate, taxpayers with long-term capital gains must go to Part IV of Schedule D to figure their tax. To determine whether you need Part IV, complete Form 1040 through line 41, Taxable Income. Then go to Part IV of Schedule D if:

- Both lines 16 and 17 of Schedule D are gains, and
- Form 1040, line 41, is more than zero.

Example 9

Edmund's tax return shows:

Filing status: Form 1040, line 1 box checked, single.

Amount from: Form 1040, line 41: \$65,001

Schedule D, line 7: (5,000)
Schedule D, line 16: 16,000
Schedule D, line 17: 11,000
(Transferred to Form 1040, line 13.)

There is capital gain on Schedule D, lines 16 and 17, and Form 1040, line 41, is more than zero.

Exhibits 8 and 9 show Edmund's Schedule D, Parts III and IV, and his Form 1040, lines 13 and 42. His tax is \$13,133. Without Schedule D, his tax from the Tax Table would be \$13,903. Using Schedule D saved Edmund \$770.

PENSION EARNER

Scho	dule D (Form 1040) 2002			2000
_	rt III Taxable Gain or Deductible Loss			Page 2
17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41	17	11,000	00
	 Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040. 			
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18	(() ///////
	 Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. 			
Do				
				_
19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions			
	If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.			
20	Enter your taxable income from Form 1040, line 41			
21	Enter the smaller of line 16 or line 17 of Schedule D			
22	If you are deducting investment interest			
	expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-			
23	Subtract line 22 from line 21. If zero or less, enter -0			
24	Subtract line 23 from line 20. If zero or less, enter -0		10.077	00
25	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25	10,933	00
26	Enter the smaller of:			
	 The amount on line 20 or \$46,700 if married filing jointly or qualifying widow(er); 			
	\$27,950 if single;			
	\$37,450 if head of household; or			
	\$23,350 if married filing separately			
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines			
	27 through 33 and go to line 34.			
27	Enter the amount from line 24			
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34			
29	Enter your qualified 5-year gain, if any, from			
	line 7 of the worksheet on page D-8 29			
30 31	Enter the smaller of line 28 or line 29	////// 31		
32	Subtract line 30 from line 28			
33	Multiply line 32 by 10% (.10)	33]	
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.			
	Enter the smaller of line 20 or line 23	. /////		
34 35	Enter the smaller of line 20 or line 23	— <i>\//////</i>		
35 36	Subtract line 35 from line 34	— <i>(///////</i>		
37	Multiply line 36 by 20% (.20)	37	2,200	00
38	Add lines 25, 31, 33, and 37	38	13,133	00
39	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	13,903	00
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40	13,133	00
			ule D (Form 1040	2002
	↔			,

12-19

12	Business income or (loss). Attach Schedule C or C-EZ	12		
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ □	13	11,000	00
14	Other gains or (lesses) Attach Form 4707	14		

41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	41		
42	Tax (see page 33). Check if any tax is from a Form(s) 8814 b Form 4972	42	13,133	00
	tak (ese page se), enter it air, tak is nem 2 = 1 entitle) est i			

Exercise 4

Melvin sold the following stocks during 2002. His broker reported net sales proceeds on Form 1099-B.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
50 sh ABC	3/15/02	7/26/02	\$4,000	\$5,000
200 sh MLG	5/10/02	6/7/02	1,200	1,000
150 sh XYZ	4/17/00	3/8/02	5,500	6,000
300 sh MLS	1/13/98	6/19/02	6,000	3,000

Melvin also had shares in a mutual fund. The fund sent him a Form 1099-DIV that showed he received \$1,500 in total capital gain distributions. His taxable income (line 41, Form 1040) was \$67,001. His filing status is single.

Use the information given to complete Melvin's Schedule D. What amounts would be shown on his:

- (A) 1. Form 1040, line 13?_____
 - 2. Form 1040, line 42?_____

(B) Complete this form.

Pa	rt I	Short-Term Ca	pital Gains a	nd Losses-	-Assets Held O	ne Year or L	ess			
		scription of property le: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other (see page D-5 of instructions)	f the	(f) Gain or (loss Subtract (e) from		
1										
						3				
				2						
2		r your short-term	totals, if any	v, from 2						
3	Total	source B-1, line 2. I short-term sale lines 1 and 2 in colu	es price am	ounts.						
4	Shor	t-term gain from Fo		hort-term gair			4			
5	Net s	short-term gain or (lo	oss) from partne	erships, S corp		and trusts	5			
6	Shor	t-term capital loss	carryover. Ente	er the amount		8 of your	6	()	
7		Capital Loss Carry					7			
	rt II	Long-Term Cap					, V	ar :		<u> </u>
ıα			(b) Date		(d) Sales price	(e) Cost or other			(g) 28% rate	gain or
		scription of property le: 100 sh. XYZ Co.)	acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(see page D-5 of the instructions)	(see page D-5 o	f the	(f) Gain or (loss Subtract (e) from	(1000)) *
8			(,,, ,,						(666 11.1611 1	1
										$\overline{}$
						<i></i>	,,,,,,	!		
9		r your long-term								
		edule D-1, line 9 .								iixiiiiii.
10		l long-term sale								
		lines 8 and 9 in colu	()		5 0400 1	<i>V////////////////////////////////////</i>				
11		from Form 4797, F term gain or (loss) f	_	-			11			
12	_	ong-term gain or (lo						1		+
12		Schedule(s) K-1.			orations, estates,	and trusts	12			
		00.1000.0(0) 11 1.								
13	Capi	tal gain distributions	s. See page D-	1 of the instru	ictions		13			
14	Long	-term capital loss c	arryover. Enter	in both colun	nns (f) and (g) the	amount, if		,		
	any,	from line 13 of your	2001 Capital I	_oss Carryove	r Worksheet		14) ()
							4-			
15	Com	bine lines 8 through	14 in column	(g)			15			
16		long-term capital on the control of		Combine line	s 8 through 14 in	column (f)	16			
***				9-1	-1.1				<u>'////////////////////////////////////</u>	<i>/////////</i>
28		e gain or loss include gain on qualified s					0-6 of	the instruction	s) and up to s	50% of
For	Paperv	vork Reduction Act N	lotice, see Form	n 1040 instruct	ions.	Cat. No. 11338H		Schedu	le D (Form 104	10) 2002

Sche	dule D (Form 1040) 2002	Page 2
Pai	t III Taxable Gain or Deductible Loss	
17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41	17
	 Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040. 	
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18 ()
	 Next: If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. Otherwise, skip Part IV below and complete the rest of Form 1040. 	
Pai	Tax Computation Using Maximum Capital Gains Rates	
19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	
	page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.	
20	Enter your taxable income from Form 1040, line 41	
21	Enter the smaller of line 16 or line 17 of Schedule D	
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-	
23 24 25 26	Subtract line 22 from line 21. If zero or less, enter -0- Subtract line 23 from line 20. If zero or less, enter -0- Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies Enter the smaller of: The amount on line 20 or \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately	25
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.	
27 28 29	Enter the amount from line 24	
31 32 33	Multiply line 30 by 8% (.08)	31
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.	
34 35 36 37 38 39	Enter the smaller of line 20 or line 23	37 38 39
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40
	&	Schedule D (Form 1040) 2002

Capital Loss Carryovers

Use the *Capital Loss Carryover Worksheet* in the Schedule D instructions to figure how much capital loss the taxpayer can carry from 2002 to 2003. As you learned earlier, a taxpayer cannot take net losses of more than \$3,000 (\$1,500 for married taxpayers filing separately) in figuring taxable income. The allowable loss for the year is also referred to as the deduction limit.

Unused losses are not gone forever. Rather, they are carried over to the next year. The carryover losses are combined with the gains and losses that actually occur in that next year. Unused losses are recycled this way, year after year, until they are all deducted. There is no limit on how many times a loss can be carried over during the taxpayer's life.

Unused losses keep their short-term or long-term classification when they are carried over. If the taxpayer has a short-term capital loss carryover from 2001, enter it on line 6, Part I, Schedule D. Enter it on line 14, Part II, if it is long-term.

Example 10 Andrew sold two stocks in 2002, as summarized here.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
200 sh FFF	5/8/01	1/6/02	\$4,000	\$ 3,025
$50 \mathrm{sh} \mathrm{WWW}$	11/6/00	3/12/02	8,700	11,000

Andrew's 2001 return showed the following capital loss carry-overs to 2002: a \$4,200 short-term loss (line 8 of the 2001 *Capital Loss Carryover Worksheet*) and a \$240 long-term loss (line 13 of the 2001 worksheet). His 2002 Form 1040, line 39, shows \$55,825.

Andrew's Schedule D, Parts I through III, his 2002 Form 1040, line 13, and his 2002 *Capital Loss Carryover Worksheet* appear below as Exhibits 12 through 15. This example shows how to:

■ Report a capital loss carryover from 2001 and work it into the computation on Schedule D as if it had resulted from a 2002 sale. This example shows both a short-term loss (reported on Schedule D, Part I, line 6) and a long-term loss (reported on Schedule D, Part II, line 14).

TAX TIPS

***** It is easy to double check the carryover from 2002 to 2003. Take as much as possible of the \$3,000 (or \$1,500) deduction from short-term capital losses first. Then take any remaining amount of the \$3,000 (or \$1,500) from longterm capital losses. What is left is the carryover to 2003.

Tax Tips *******

Capital Loss Carryover Worksheet is included in the Tax Forms Booklet Appendix.

POTENTIAL PITFALLS



In completing
Schedule D, remember to include the amounts from lines 1 and 2, as well as from line 6, when you complete line 7 (Part I); and the amounts from lines 8 and 9, as well as from lines 13 and 14, when you complete line 16 (Part II).

- Combine a short-term capital loss and a long-term capital loss and apply the deduction limit (\$3,000 for Andrew). Andrew reports the combined long-term and short-term loss on Schedule D, Part III, line 17. Line 18 applies Andrew's deduction limit, his allowable loss for the year.
- Show the allowable loss for the year (\$3,000 for Andrew) in the Income section of Form 1040.
- Use the *Capital Loss Carryover Worksheet* to apply the \$3,000 deduction limit against the short-term loss first and figure the capital loss carryover to 2003. In this case, the carryover is a short-term loss of \$225 (line 8 of the worksheet) and a long-term loss of \$2,540 (line 13 of the worksheet).

PENSION EARNER

Do	Short Torm Car	nital Gains a	nd Lossos	Accete Hold O	no Voor or	Loco		-	
FE	rt I Short-Term Cap	(b) Date		(d) Sales price	(e) Cost or other			. ///	
_	(a) Description of property (Example: 100 sh. XYZ Co.)	acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(see page D-5 of the instructions)	(see page D-5	of the	(f) Gain or (lo Subtract (e) from		
1	200 sh. FFF	5/8/01	1/6/02	4,000 00	3,025	3 00	975	00	
		2, 2, 2 =	4						
			6.30	C P					
2	Enter your short-term Schedule D-1, line 2	totals, if any	, from <u>2</u>						
3	Total short-term sale Add lines 1 and 2 in colu		ounts.	4,000 00					
4	Short-term gain from For 6781, and 8824	rm 6252 and s	hort-term ga	in or (loss) from Fo	orms 4684,	4			
5	Net short-term gain or (lo from Schedule(s) K-1			•		5			
6	Short-term capital loss of 2001 Capital Loss Carryo					6	(4,200	00)	
7	Net short-term capital					7	(3,225	00)	
Pa	rt II Long-Term Cap		ia Losses-					1,	000/
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other (see page D-5 instruction	of the	(f) Gain or (lo Subtract (e) from	m (d)	28% rate gain or (loss) * (see instr. below)
8	50 sh. WWW	11/6/00	3/12/0	2 8,700 00	11,000	00	(2,300	00)	
9	Enter your long-term	totals, if any						+	
10	Schedule D-1, line 9 Total long-term sale		ounts.	0,000,00					
11	Add lines 8 and 9 in colu Gain from Form 4797, F	Part I; long-ter	m gain from	Forms 2439 and	6252; and		<i>X////////////////////////////////////</i>		
12	long-term gain or (loss) f Net long-term gain or (los					11			
	from Schedule(s) K-1.					12			
13	Capital gain distributions					13			
14	Long-term capital loss ca any, from line 13 of your					14	(240	00) (240 00)
15	Combine lines 8 through	14 in column	(g)			15			(240 00
16	Net long-term capital g Next: Go to Part III on the		Combine line	es 8 through 14 in	column (f)	16	(2,540	00)	
	% rate gain or loss included eligible gain on qualified si						f the instructi	ons) an	d up to 50% of
	Paperwork Reduction Act N		· '		Cat. No. 11338	1	Sched	dule D (I	Form 1040) 2002

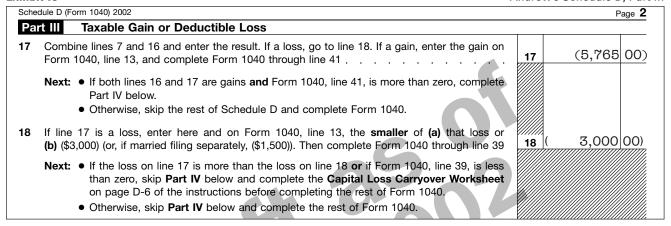


Exhibit 14 Andrew's Form 1040, line 13

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐ 13 (3,000 00)

Exhibit 15

Andrew's Capital Loss Carryover Worksheet

Capital Loss Carryover Worksheet—Line 18	Keep for Your Records
Use this worksheet to figure your capital loss carryovers from 2002 to 2003 if Schedule D, line smaller loss than the loss on Schedule D, line 17, or (b) Form 1040, line 39, is a loss. Otherwise	
1. Enter the amount from Form 1040, line 39. If a loss, enclose the amount in parentheses .	1. 55,825.00
2. Enter the loss from Schedule D, line 18, as a positive amount	
3. Combine lines 1 and 2. If zero or less, enter -0	
4. Enter the smaller of line 2 or line 3	
If line 7 of Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to lin	ne 9.
5. Enter the loss from Schedule D, line 7, as a positive amount	5. <u>3,225. 00</u>
6. Enter any gain from Schedule D, line 16	0. 00
7. Add lines 4 and 6	
8. Short-term capital loss carryover to 2003. Subtract line 7 from line 5. If zero or less, enter	000 00
If line 16 of Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.	
9. Enter the loss from Schedule D, line 16, as a positive amount	9. <u>2,540. 00</u>
10. Enter any gain from Schedule D, line 7	0. 00
11. Subtract line 5 from line 4. If zero or less, enter -0	
12. Add lines 10 and 11	
13. Long-term capital loss carryover to 2003. Subtract line 12 from line 9. If zero or less, enter	0.040.00

Exercise 5

This exercise and the next one review the concepts covered in this lesson. They will measure your ability to apply what you have learned.

Matthew has a Form 1099-B from Broker One, who reported gross proceeds:

Stock	Date Sold	Sales Price			
100 sh MNO 500 sh ZYX	2/8/02 8/7/02	\$5,050 5,250			
Broker One reported sales commissions to Matthew separately. They were:					

MNO: \$50 ZYX: \$200

Matthew also has a Form 1099-B from Broker Two, who reported net proceeds:

Stock	Date Sold	Sales Price
200 sh BCA	8/7/02	\$4,000
300 sh JKL	8/7/02	5,910

Matthew gave you the following information about the stocks he sold:

- He paid \$6,940, plus a \$60 commission, to buy the MNO stock on February 9, 2001.
- He bought the ZYX on March 11, 2000, for \$5,200, plus a \$100 commission.
- He paid \$3,900, plus a \$50 commission, to buy the BCA stock on January 29, 2002.
- He bought the JKL on June 26, 2001, for \$6,300, plus a \$30 commission.

Matthew's filing status is head of household. His Form 1040, line 39, shows \$55,282. When you look at Matthew's Form 1040 and Capital Loss Carryover Worksheet from 2001, you see that he has a \$450 short-term loss and a \$325 long-term loss that he can carry over to his 2002 return.

Use this information to complete Matthew's Schedule D, Parts I, II, and III, and his Form 1040, line 13, for 2002. Also complete the *Capital Loss Carryover Worksheet* to figure how much capital loss he can carry over to 2003.

OMB No. 1545-0074

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service

Capital Gains and Losses

► Attach to Form 1040.

► See Instructions for Schedule D (Form 1040).

Attachment

Sequence No. 12

▶ Use Schedule D-1 to list additional transactions for lines 1 and 8. Name(s) shown on Form 1040 Your social security number Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less (d) Sales price (see page D-5 of (e) Cost or other basis (c) Date sold (f) Gain or (loss) acquired (Mo., day, yr.) (see page D-5 of the instructions) (Example: 100 sh. XYZ Co.) (Mo., day, yr.) the instructions) 1 2 Enter your short-term totals, if any, from Schedule D-1, line 2. Total short-term sales price amounts. Add lines 1 and 2 in column (d) . Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts 5 from Schedule(s) K-1 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet 7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f). Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year (e) Cost or other basis (see page D-5 of the instructions) (b) Date acquired (d) Sales price (see page D-5 of (g) 28% rate gain or (a) Description of property (Example: 100 sh. XYZ Co.) (c) Date sold (f) Gain or (loss) Subtract (e) from (d) (Mo., day, yr.) (Mo., day, yr.) the instructions) (see instr. below) 8 Enter your long-term totals, if any, from Schedule D-1, line 9 Total long-term sales price amounts. 10 Add lines 8 and 9 in column (d) Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and 11 long-term gain or (loss) from Forms 4684, 6781, and 8824 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts 12 13 13 Capital gain distributions. See page D-1 of the instructions Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if 14 any, from line 13 of your 2001 Capital Loss Carryover Worksheet . . . 15 Combine lines 8 through 14 in column (g) Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) 16 Next: Go to Part III on the back. *28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of

the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11338H

Schedule D (Form 1040) 2002

Exhibit 17

(B) Complete this form.

Schedule D, Part III

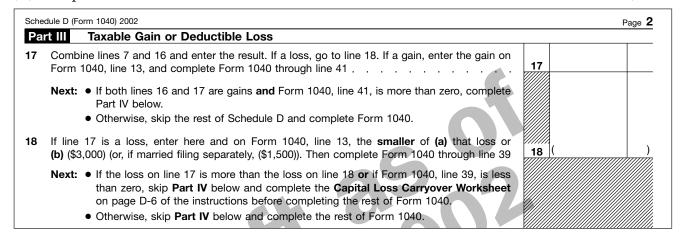


Exhibit 18

(C) Complete this line on Matthew's Form 1040.

Form 1040, line 13

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here

Exhibit 19

(D) Complete this worksheet.

Capital Loss Carryover Worksheet



Capital Loss Carryover Worksheet—Line 18	Keep for Your Records	K
Use this worksheet to figure your capital loss carryovers from 2002 to 2003 if Schedule D smaller loss than the loss on Schedule D, line 17, or (b) Form 1040, line 39, is a loss. Other		
1. Enter the amount from Form 1040, line 39. If a loss, enclose the amount in parentheses	s 1.	
2. Enter the loss from Schedule D, line 18, as a positive amount	2.	
3. Combine lines 1 and 2. If zero or less, enter -0	3.	
4. Enter the smaller of line 2 or line 3	4.	
If line 7 of Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to		
5. Enter the loss from Schedule D, line 7, as a positive amount	5	
6. Enter any gain from Schedule D, line 16		
7. Add lines 4 and 6	7.	
8. Short-term capital loss carryover to 2003. Subtract line 7 from line 5. If zero or less,		
If line 16 of Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.		
9. Enter the loss from Schedule D, line 16, as a positive amount	9.	
10. Enter any gain from Schedule D, line 7		
11. Subtract line 5 from line 4. If zero or less, enter -0		
12. Add lines 10 and 11		
13. Long-term capital loss carryover to 2003. Subtract line 12 from line 9. If zero or less.		

Exercise 6

Katherine has two Forms 1099-B. They show:

From Broker No. 1 (gross proceeds reported):

Stock	Date Sold	Sales Price
100 sh LMN	4/20/02	\$3,000
50 sh PQR	4/12/02	2,600
500 sh OLE	4/17/02	7,800

Expenses for selling the stock through Broker No. 1 (reported to Katherine separately from Form 1099-B) were:

On the sale of: LMN stock: \$175 PQR stock: \$105 OLE: \$590

From Broker No. 2 (net proceeds reported):

Stock	Date Sold	Sales Price
75 sh ABC	1/24/02	\$2,500
125 sh XYZ	3/22/02	6,000

Katherine gave you the following information about these stocks:

- She bought 100 shares of LMN stock on March 6, 2000, for \$12.50 a share (\$1,250), plus a 10% broker's commission (\$125).
- She bought 200 shares of PQR stock on January 8, 2002, for \$14 a share (\$2,800), plus a 10% broker's commission (\$280).
- Katherine bought OLE stock on two dates. On November 27, 2000, she bought 800 shares for \$10 a share (\$8,000), plus 10% broker's commission (\$800). On March 6, 2002, she bought 600 more shares for \$18 a share (\$10,800), plus a 10% broker's commission (\$1,080). When Katherine sold 500 shares of OLE in 2002, she did not specify which block they came from.
- Katherine bought 100 shares of ABC on October 15, 1999, for \$72 a share (\$7,200), plus a 5% broker's commission (\$360). On May 8, 2000, the stock split two-for-one, so Katherine owned 200 shares after the split.
- She bought 125 shares of XYZ stock on October 26, 2001, for \$74 a share (\$9,250), plus a broker's commission of \$250.

Katherine also gave you a Form 1099-DIV from the Acme Mutual Fund. It showed \$1,050 in total capital gain distributions. From Katherine's tax return and worksheets for last year (2001), you found she has a \$150 long-term capital loss carryover from 2001 to 2002.

Complete Katherine's Schedule D, Parts I through IV, and her Form 1040, lines 13 and 42. She is single, and her taxable income shown on line 41 of her Form 1040 is \$61,221.

Pa	rt I Short-Term Cap	pital Gains a	nd Losse:	s—Assets Hel	d One `	Year or Le	ss	
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sol (Mo., day, y		of (see	Cost or other bate page D-5 of the instructions)	(f) Gain or (loss) he Subtract (e) from (c	d)
1								
					1	7		
							16	
2	Enter your short-term	totals, if any	from					
3	Schedule D-1, line 2. Total short-term sale			2				
	Add lines 1 and 2 in colu	umn (d)		3				
4						4	1	
5	Net short-term gain or (lo from Schedule(s) K-1			orporations, esta		-	5	
6	Short-term capital loss 2001 Capital Loss Carry	carryover. Ente	r the amou	unt, if any, from	line 8 c	of your	s ()
7	Net short-term capital						,	
	rt II Long-Term Cap							<u> </u>
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sol	d (d) Sales prid	e (e) (Cost or other ba e page D-5 of the instructions)	sis (f) Gain or (loss)	
8	· · · · · · · · · · · · · · · · · · ·	(IVIO., day, yr.)		the instruction	15)	instructions)		(see instr. below)
						- !		
								+
9	Enter your long-term Schedule D-1, line 9.			9				
10	Total long-term sale		ounts.					
11	Add lines 8 and 9 in colu Gain from Form 4797, F	` ,		0 Eorms 2420 c	nd 625	?: and		
•	long-term gain or (loss) f	from Forms 46	34, 6781, a	nd 8824		<u> 1</u>	1	
2	Net long-term gain or (los from Schedule(s) K-1.	ss) from partne	rships, S co	orporations, esta	tes, and	I trusts	2	
	,,							
3 4	Capital gain distributions Long-term capital loss c				 the ama	—	3	
7	any, from line 13 of your	•		() (0)			4 () (
15	Combine lines 8 through	14 in column	(g)			<u>1</u>	5	
16	Net long-term capital g		Combine li	nes 8 through 1	1 in colu	umn (f) 1	6	
*	Next: Go to Part III on th							
28 he	% rate gain or loss included a	des all "collect mall business	bles gains stock (see	and losses" (as opage D-4 of the	defined (instructi	on page D-6 ions).	of the instruction	s) and up to 50% o
or	Paperwork Reduction Act N	lotice, see Forn	1040 instru	ıctions.	Cat.	No. 11338H	Schedul	e D (Form 1040) 200

$(B) \ Complete \ this \ form.$

	dule D (Form 1040) 2002	Page 2
17	Taxable Gain or Deductible Loss Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on	
17	Form 1040, line 13, and complete Form 1040 through line 41	17
	 Next: ● If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. ● Otherwise, skip the rest of Schedule D and complete Form 1040. 	
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18 ()
	 Next: If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. Otherwise, skip Part IV below and complete the rest of Form 1040. 	
Pa	rt IV Tax Computation Using Maximum Capital Gains Rates	<u> </u>
19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	
	22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.	
20	Enter your taxable income from Form 1040, line 41	
21	Enter the smaller of line 16 or line 17 of	
	Schedule D	
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952 line 4e Otherwise enter -0-	
23	from Form 4952, line 4e. Otherwise, enter -0-	
24	Subtract line 23 from line 20. If zero or less, enter -0	
25 26	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies Enter the smaller of:	25
	• The amount on line 20 or	
	• \$46,700 if married filing jointly or qualifying widow(er);	
	\$27,950 if single; \$37,450 if head of household; or	
	\$23,350 if married filing separately	
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines	
	27 through 33 and go to line 34.	
27	Enter the amount from line 24	
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34	
29	Enter your qualified 5-year gain, if any, from	
00	line 7 of the worksheet on page D-8	
30 31	Enter the smaller of line 28 or line 29	31
32	Subtract line 30 from line 28	
33	Multiply line 32 by 10% (.10)	33
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38. $$	
34	Enter the smaller of line 20 or line 23	
35	Enter the amount from line 28 (if line 28 is blank, enter -0-) 35	
36	Subtract line 35 from line 34	
37	Multiply line 36 by 20% (.20)	37
38 39	Add lines 25, 31, 33, and 37	38 39
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here	
	and on Form 1040, line 42	40
	⊕	Schedule D (Form 1040) 2002

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Lesson 12

Exhibit 22

(C) Complete these lines from Katherine's Form 1040.

Form 1040, lines 13 and 40

12	Business income or (loss). Attach Schedule C or C-EZ	ΙZ			_
13	13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ □				_
14	Other gains or (losses). Attach Form 4797	14			
41	Taxab e income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	. –	41		
42	Tax (see page 33). Check if any tax is from a Form(s) 8814 b Form 4972		42		
43	Alternative minimum tax (see page 34) Attach Form 6251		43		

▶▶ SUMMING UP THIS LESSON ◀◀

To figure and properly report a taxpayer's gain or loss on a sale of stock, you need to know:

- 1. Sales price (reported to the taxpayer and to the IRS on Form 1099-B),
- 2. Adjusted basis, and
- 3. Holding period.

To determine gain or loss, subtract adjusted basis from sales price. The holding period determines whether the gain or loss is long-term or short-term. Long-term capital gains are generally taxed at lower rates than short-term capital gains.

Use Schedule D, Parts I though IV, to figure capital gain or loss and the correct tax. Be sure the total sales price you report on line 3 plus line 10 of Schedule D is the same as the total sales price from all the taxpayer's Forms 1099-B, box 2.

Include capital gain distributions (reported to the taxpayer and to IRS on Form 1099-DIV) in the computation of long-term capital gains. Show them on Schedule D, Part II, line 13. Report capital gains distributions directly on Form 1040, line 13 (or on Form 1040A, line 10), if a Schedule D is not required to be completed for the gain or loss on a sale of stock.

A taxpayer can deduct up to \$3,000 (\$1,500 for a married taxpayer filing separately) in net capital loss for the year. The taxpayer can carry over any remaining loss to the next year. If the taxpayer has a carryover loss from 2001, include it on Schedule D, Part I, line 6, or Part II, line 14. The *Capital Loss Carryover Worksheet*, in the Schedule D instructions, can help you figure the carryover amount for 2003.

Report capital gain or loss on Form 1040, line 13.

Lesson 12

SALE OF STOCK Answers to Exercises

Exercise 1

- A. 1. \$2,550. [(\$5,000 + \$100) $\div 1,000$] x 500 = \$2,550
 - 2. Long-term.
 - 3. \$3,255. \$3,300 \$45 = \$3,255
- B. 1. \$3,550. \$3,500 + \$50 = \$3,550
 - 2. Short-term.
- C. 1. \$5,000. $[(\$9,965 + \$35) \div 200] \times 100 = \$5,000$
 - 2. Long-term.
 - 3. \$6,440. \$6,470 \$30 = \$6,440

Exercise 2

- A. 1. Loss.
 - 2. $\$1,200. \$7,800 [(\$15,000 \div 1,000) \times 600] = (\$1,200)$
 - 3. Short-term.
- B. 1. Gain.
 - 2. \$450. \$2,000 (\$1,500 + \$25 + \$25) = \$450
 - 3. Long-term.

Exercise 3

Jane's Schedule D, Parts I and II

Pa	rt I Short-Term Cap		nd Losses-						
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or of (see page Dinstructi	5 of the	(f) Gain or (lo Subtract (e) fro		
1 50	00 sh. LSR	1/12/01	1/4/02	4,000 0	9,00	0 00	(5,000	00)	
25	60 sh. BGI	3/11/01	2/12/02	10,000 0	2,50	0 00	7,500	00	
			633						
2	Enter your short-term Schedule D-1, line 2	totals, if any	r, from 2						
3	Total short-term sale Add lines 1 and 2 in colu	es price am	nounts.	14,000 0	0				
4	Short-term gain from For	. ,		or (loss) from I		4			
5	Net short-term gain or (lo from Schedule(s) K-1	ss) from partne	erships, S corp	orations, estate		5			
6	Short-term capital loss of 2001 Capital Loss Carryo	carryover. Ente		, if any, from lir		6	()	
7	Net short-term capital g					7	2,500	00	
	rt II Long-Term Cap	<u> </u>			. ,			00	
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or of	her basis 5 of the	(f) Gain or (lo Subtract (e) fro		(g) 28% rate gain (loss) * (see instr. below)
8 75	sh. ABC	1/22/01	1/29/02	2,000 0		0 00	(5,500	00)	(GGG MIGHT BEIGH)
40	00 sh. XYZ	12/3/99	3/6/02	15,000 0	10,00	0 00	5,000	00	
10	00 sh. DEF	4/2/99	1/16/02	1,200 0	2,00	0 00	(800	00)	
9	Enter your long-term Schedule D-1, line 9								
0	Total long-term sale Add lines 8 and 9 in colu	s price am	ounts.	18,200 00					
1	Gain from Form 4797, Flong-term gain or (loss) fi	art İ; long-ter	m gain from			11			
2	Net long-term gain or (los from Schedule(s) K-1.				•	12			
3	Capital gain distributions	. See page D-	1 of the instru	ictions		13	1,200	00	
4	Long-term capital loss ca any, from line 13 of your				e amount, if	14	()	(
5	Combine lines 8 through	14 in column	(g)			15			
6	Net long-term capital g Next: Go to Part III on th		Combine line	s 8 through 14 i	n column (f)	16	(100	00)	
_									
28	% rate gain or loss include eligible gain on qualified si	les all "collect	ibles gains an	d losses" (as de	fined on page	e D-6 o	f the instruct	ions)	and up to 50%

SALE OF STOCK Answers to Exercises

Exercise 4

(A) 1. Form 1040, line 13: \$3,200

2. Form 1040, line 42: \$14,219

(B) Melvin's Schedule D, Page 1

Da									
пe	rt I Short-Term Cap	oital Gains a	nd Losses—	-Assets Held O	ne Year or	Less			
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (le Subtract (e) fro		
1	50 sh. ABC	3/15/02	7/26/02	4,000 00	5,000	00	(1,000	00)	
	200 sh. MLG	5/10/02	6/7/02	1,200 00	1,000	00	200	00	
			CX						
						,,,,,,,			
2	Enter your short-term Schedule D-1, line 2	totals, if any	/, from 2						
3	Total short-term sale Add lines 1 and 2 in colu		nounts. 3	5,200 00					
4	Short-term gain from For 6781, and 8824	rm 6252 and s		or (loss) from Fo		4			
5	Net short-term gain or (lo from Schedule(s) K-1	ss) from partne	erships, S corp	oorations, estates,	and trusts	5			
6	Short-term capital loss of 2001 Capital Loss Carryo					6	()	
7	Net short-term capital					7	(800	00)	
Pa	rt II Long-Term Cap		nd Losses—				ear		
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (le Subtract (e) fro		(g) 28% rate gain (loss) * (see instr. below)
8	150 sh. XYZ	4/17/00	3/8/02	5,500 00	6,000	00	(500	00)	
	300 sh. MLS	1/13/98	6/19/02	6,000 00	3,000	00	3,000	00	
	300 sh. MLS	1/13/98	6/19/02	6,000 00	3,000	00	3,000	00	
				6,000 00	3,000	00	3,000	00	
9	Enter your long-term Schedule D-1, line 9	totals, if any	/, from 9	6,000 00	3,000	00	3,000	00	
10	Enter your long-term Schedule D-1, line 9 Total long-term sale Add lines 8 and 9 in colu	totals, if any	7, from 9 nounts.	11,500 00		00	3,000	00	
10 11	Enter your long-term Schedule D-1, line 9 Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, F long-term gain or (loss) f	totals, if any s price an Imm (d) Part I; long-ter rom Forms 46	7, from 9 10 10 10 10 10 10 10 10 10 10 10 10 10 1	11,500 00 Forms 2439 and 0	6252; and	11	3,000	00	
10 11	Enter your long-term Schedule D-1, line 9 Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, F	totals, if any s price an Imm (d) Part I; long-ter rom Forms 46	7, from 9 10 10 10 10 10 10 10 10 10 10 10 10 10 1	11,500 00 Forms 2439 and 0	6252; and				
10 11 12	Enter your long-term Schedule D-1, line 9. Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, Flong-term gain or (loss) f Net long-term gain or (los from Schedule(s) K-1. Capital gain distributions	totals, if any s price any umn (d) Part I; long-ter rom Forms 46 ss) from partne	y, from y nounts. 10 m gain from F 84, 6781, and erships, S corp	11,500 00 Forms 2439 and 68824 orations, estates,	6252; and and trusts	11	1,500		
9 10 11 12 13	Enter your long-term Schedule D-1, line 9 Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, F long-term gain or (loss) f Net long-term gain or (los from Schedule(s) K-1	totals, if any s price any umn (d) . Part I; long-ter rom Forms 46 ss) from partne	r, from 9 nounts. 10 m gain from F 84, 6781, and erships, S corp 1 of the instruction both column	11,500 00 Forms 2439 and 68824	6252; and and trusts	11			(
10 11 12	Enter your long-term Schedule D-1, line 9 Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, Flong-term gain or (loss) f Net long-term gain or (los from Schedule(s) K-1 Capital gain distributions Long-term capital loss of	totals, if any s price am umn (d) Part I; long-ter rom Forms 46 ss) from partne See page D- arryover. Enter 2001 Capital I	nounts. 10 m gain from F84, 6781, and erships, S corp 1 of the instruin both columnoss Carryover	11,500 00 Forms 2439 and 68824	6252; and and trusts	11 12 13	1,500	000	
10 11 12 13 14	Enter your long-term Schedule D-1, line 9. Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, Flong-term gain or (loss) f Net long-term gain or (los from Schedule(s) K-1. Capital gain distributions Long-term capital loss cany, from line 13 of your	totals, if any spice amumn (d) . Part I; long-ter rom Forms 46 ss) from partner	r, from 9 nounts. 10 m gain from F84, 6781, and erships, S corp 1 of the instruction both columnoss Carryover	11,500 00 Forms 2439 and 68824 orations, estates, ctions thins (f) and (g) the r Worksheet	6252; and	11 12 13		000	
0 1 2 3 4 5 6	Enter your long-term Schedule D-1, line 9. Total long-term sale Add lines 8 and 9 in colu Gain from Form 4797, Flong-term gain or (loss) f Net long-term gain or (los from Schedule(s) K-1. Capital gain distributions Long-term capital loss cany, from line 13 of your Combine lines 8 through	s price and amm (d)	nounts. 10 m gain from f84, 6781, and erships, S corp 1 of the instruction both columnoss Carryover (g)	11,500 00 Forms 2439 and 68824 orations, estates,	6252; and and trusts amount, if column (f)	11 12 13 14 15	1,500	00	(and up to 50%

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(C) Melvin's Schedule D, Page 2

	till Taxable Gain or Deductible Loss		Page 2
7	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on		Τ
	Form 1040, line 13, and complete Form 1040 through line 41	17 3,200	00
	Next: ● If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete		
	Part IV below.		
	Otherwise, skip the rest of Schedule D and complete Form 1040.		
8	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18 (
	Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less		
	than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet		
	on page D-6 of the instructions before completing the rest of Form 1040.		
	 Otherwise, skip Part IV below and complete the rest of Form 1040. 		
Par	t IV Tax Computation Using Maximum Capital Gains Rates		
9	Enter your unrecaptured section 1250 gain,		
	if any, from line 17 of the worksheet on		
	page D-7 of the instructions		
	If line 15 or line 19 is more than zero, complete the worksheet on		
	page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise,		
	go to line 20.		
0	Enter your taxable income from Form 1040, line 41		
1	Enter the smaller of line 16 or line 17 of		
	Schedule D		
2	If you are deducting investment interest		
	expense on Form 4952, enter the amount from Form 4952 line 4e Otherwise enter -0- 22 0 00		
	T 200 00		
:3 :4	Subtract line 22 from line 21. If zero or less, enter -0		
. - :5	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25 13,579	00
6	Enter the smaller of:		
	The amount on line 20 or		
	• \$46,700 if married filing jointly or qualifying widow(er);		
	\$27,950 if single; 26 27,950 00		
	\$37,450 if head of household; or		
	\$23,350 if married filing separately		
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines		
	27 through 33 and go to line 34.		
7	Enter the amount from line 24		
8	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34		
9	Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 29		
0	Enter the smaller of line 28 or line 29		
1	Multiply line 30 by 8% (.08)	31	
2	Subtract line 30 from line 28		
3	Multiply line 32 by 10% (.10)	33	
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.		
.4	Enter the smaller of line 20 or line 23		
4 5	Enter the smaller of line 20 or line 23		
6	Subtract line 35 from line 34		
7	Multiply line 36 by 20% (.20)	37 640	_
8	Add lines 25, 31, 33, and 37	38 14,219	
9	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39 14,443	100
0	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40 14,219	00
	and on Form 1040, line 42	ichedule D (Form 104	

SALE OF STOCK

Answers to Exercises

Exercise 5

(A) Matthew's Schedule D, Parts I and II

A) W	latthew's Schedule	e D, Parts	I and II					
Pa	rt I Short-Term Ca	oital Gains a	nd Losses—	Assets Held O	ne Year or	Less		<u> </u>
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or othe (see page D-5 instructions	r basis of the		
1	100 sh. MNO	2/9/01	2/8/02	5,050 00	7,050	00	(2,000 00)	
	200 sh. BCA	1/29/02	8/7/02	4,000 00	3,950	00	50 00	
				10				
2	Enter your short-term Schedule D-1, line 2.		. 2					
3	Total short-term sale Add lines 1 and 2 in colu	ımn (d)	. 3	9,050 00				
4						4		
5	Net short-term gain or (lo from Schedule(s) K-1					5		
6	Short-term capital loss of 2001 Capital Loss Carryo	carryover. Ente over Workshee	er the amount, t	if any, from line	8 of your	6	(450 00)	
7	Net short-term capital					7	(2,400 00)	
Pa	rt II Long-Term Cap		nd Losses—					
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8	500 sh. ZYX	3/11/00	8/7/02	5,250 00	5,500	00	(250 00)	
	300 sh. JKL	6/26/01	8/7/02	5,910 00	6,330	00	(420 00)	
9	Enter your long term	totala if any	from					
10	Enter your long-term Schedule D-1, line 9 Total long-term sale		9					
11	Add lines 8 and 9 in colu Gain from Form 4797, F	ımn (d)	10	11,160 00	6252: and			
	long-term gain or (loss) f	rom Forms 46	84, 6781, and	8824		11		
12	Net long-term gain or (los from Schedule(s) K-1.	ss) from partne	rships, S corpo	orations, estates,	and trusts	12		
13	Capital gain distributions					13		
14	Long-term capital loss canny, from line 13 of your	,		()	amount, if	14	(325 00)	(325 00)
15	Combine lines 8 through	14 in column	(g)			15		(325 00)
16	Net long-term capital g Next: Go to Part III on the		Combine lines	8 through 14 in	column (f)	16	(995 00)	
* 28 the	8% rate gain or loss included eligible gain on qualified s	des all "collecti mall business	ibles gains and	d losses" (as defir	ned on page I	D-6 o	f the instructions)	and up to 50% of
	Paperwork Reduction Act N				Cat. No. 11338H	l	Schedule	D (Form 1040) 2002

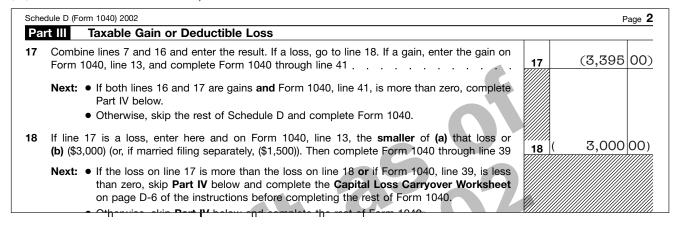
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Lesson 12

SALE OF STOCK Answers to Exercises

Lesson 12

(B) Matthew's Schedule D, Part III



(C) Matthew's Form 1040, Line 13

13	Capital gain or (loss). Attach Schedule D if required. If not required, check here	13	(3,000	00)

(D) Matthew's Capital Loss Carryover Worksheet

capital Loss Carryover Worksheet—Line 18	Keep for Your Reco	ords \$
Use this worksheet to figure your capital loss carryovers from 2002 to 2003 if Schedule D, smaller loss than the loss on Schedule D, line 17, or (b) Form 1040, line 39, is a loss. Other		
1. Enter the amount from Form 1040, line 39. If a loss, enclose the amount in parentheses	1	55,282 00
2. Enter the loss from Schedule D, line 18, as a positive amount		3,000 0
3. Combine lines 1 and 2. If zero or less, enter -0	3	58,282 0
4. Enter the smaller of line 2 or line 3		3,000 0
If line 7 of Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to		
5. Enter the loss from Schedule D, line 7, as a positive amount		2,400 0
6. Enter any gain from Schedule D, line 16		
7. Add lines 4 and 6	7.	3,000 0
8. Short-term capital loss carryover to 2003. Subtract line 7 from line 5. If zero or less, e		
If line 16 of Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.		
9. Enter the loss from Schedule D, line 16, as a positive amount	9.	995 0
10. Enter any gain from Schedule D, line 7	0	
11. Subtract line 5 from line 4. If zero or less, enter -0	300 00	
12. Add lines 10 and 11		600 0
13. Long-term capital loss carryover to 2003. Subtract line 12 from line 9. If zero or less,		395 0

SALE OF STOCK

Answers to Exercises

Exercise 6

Basis Computations:

LMN:

100 shares bought at \$12.50	=	\$1,250
Commission on purchase	=	125
Commission on sale	=	+ 175
Adjusted basis, LMN sold	=	\$1,550

PQR:

<u> </u>		
200 shares bought at \$14	=	\$2,800
Commission on purchase	=	+ 280
Total paid for purchase	=	3,080
Divided by number of shares bought		÷ 200
Per share basis after purchase	=	15.40
Times number of shares sold		x 50
	=	770
Commission on sale	=	+ 105
Adjusted basis, PQR sold	=	\$ 875

<u>OLE:</u> Katherine did not specify which block of stock to sell; the stocks sold are assumed to be from the block purchased first.

800 shares bought at \$10	=	\$8,000
Commission on purchase	=	+ 800
Total paid for purchase	=	8,800
Divided by number of shares bought		<u>÷ 800</u>
Per share basis after purchase	=	11
Times number of shares sold		<u>x 500</u>
	=	5,500
Commission on sale	=	+ 590
Adjusted basis, OLE sold	=	\$6,090

SALE OF STOCK	Answers to Exercises
	/ INCOVERS TO EXERCISE

Lesson 12

ABC:			
100 shares bought at \$72	=	\$7,200	
Commission on purchase	=	+ 360	
Total paid for purchase	=	7,560	
Divided by number of shares			
Katherine held after the two-for	one split	÷ 200	
Per share basis after the split	=	37.80	
Times number of shares sold	=	<u>x 75</u>	
Adjusted basis, ABC sold	=	\$2,835	
XYZ:			
125 shares bought at \$74	=	\$9,250	
Commission on purchase	=	+ 250	
Adjusted basis, XYZ sold	=	\$9,500	

Lesson 12

SALE OF STOCK Answers to Exercises

Exercise 6

(A) Katherine's Schedule D, Parts I and II

Pa	rt I Short-Term Ca	oital Gains a	nd Losses		ld O	ne Year or	Less			
	(a) Description of property	(b) Date	(c) Date solo	d) Sales p	rice	(e) Cost or other	er basis		oss)	
_	(Example: 100 sh. XYZ Co.)	acquired (Mo., day, yr.)	(Mo., day, yr	the instructi		(see page D-5 instruction		Subtract (e) fro		
1	50 sh. PQR	1/8/02	4/12/02	2,600	00	875	00	1,725	00	
	125 sh. XYZ	10/26/01	3/22/02	6,000	00	9,500	00	(3,500	00)	
				2 C	人					
2	Enter your short-term	totals, if any		11						
3	Schedule D-1, line 2	s price an		8,600	00					
4	Add lines 1 and 2 in colu Short-term gain from For			3 1	<u> </u>	rms 4684				
	6781, and 8824						4			
5	Net short-term gain or (lo from Schedule(s) K-1						5			
6	Short-term capital loss 2001 Capital Loss Carry			ınt, if any, fron 	n line 	8 of your	6	()	
7	Net short-term capital	gain or (loss).	Combine li	nes 1 through	6 in c	olumn (f).	7	(1,775	00)	
Pa	rt II Long-Term Cap	oital Gains a	nd Losses	—Assets He	ld M	ore Than O	ne Y	ear		
	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date solo (Mo., day, yr		-5 of	(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (I Subtract (e) fro		(g) 28% rate gain or (loss) * (see instr. below)
8	100 sh. LMN	3/6/00	4/20/02	3,000	00	1,550	00	1,450	00	
	500 sh. OLE	11/27/00	4/17/02	7,800	00	6,090	00	1,710	00	
	75 sh. ABC	10/15/99	1/24/02	2,500	00	2,835	00	(335	00)	
9	Enter your long-term			9						
10	Schedule D-1, line 9 Total long-term sale	s price an	nounts.							
11	Add lines 8 and 9 in colu Gain from Form 4797, F	Part I; long-ter	m gain fron		and	6252; and		<i>(((((((((((((((((((((((((((((((((((((</i>	<i>(//////</i>	
12	long-term gain or (loss) f Net long-term gain or (los						11			
	from Schedule(s) K-1.						12	1.050		
13	Capital gain distributions						13	1,050	00	
14	Long-term capital loss cany, from line 13 of your						14	(150	00)	(150 00)
15	Combine lines 8 through	14 in column	(g)				15			(150 00)
16	Net long-term capital g		Combine lin	nes 8 through	14 in	column (f)	16	3,725	00	
*	Next: Go to Part III on the						<i>\\\\\\\</i>	<u> </u>		//////////////////////////////////////
28 the	% rate gain or loss included with the selection of the se	des all "collect mall business	ibles gains a stock (see p	and losses" (as page D-4 of the	defir instr	ned on page ructions).	D-6 o 	f the instruct	tions)	and up to 50% o
For	Paperwork Reduction Act N	lotice, see Forn	1040 instru	ctions.		Cat. No. 11338	+	Sche	dule I	O (Form 1040) 200

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Lesson 12

(B) Katherine's Schedule D, Parts III and IV

	till D (Form 1040) 2002 Taxable Gain or Deductible Loss		Р	age 2
17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on	17	1,950	00
	Form 1040, line 13, and complete Form 1040 through line 41		2,000	
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18 () //////
	 Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. 			
Pai	t IV Tax Computation Using Maximum Capital Gains Rates			
19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions			
20	Enter your taxable income from Form 1040, line 41			
21	Enter the smaller of line 16 or line 17 of Schedule D			
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-			
23	Subtract line 22 from line 21. If zero or less, enter -0- 23 1,950 00			
24	Subtract line 23 from line 20. If zero or less, enter -0		10.750	00
25	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25	12,350	OC
26	Enter the smaller of: ● The amount on line 20 or			
	• \$46,700 if married filing jointly or qualifying widow(er);			
	\$27,950 if single;			
	\$37,450 if head of household; or			
	\$23,350 if married filing separately			
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines			
	27 through 33 and go to line 34.			
27	Enter the amount from line 24			
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34			
29	Enter your qualified 5-year gain, if any, from			
30	line 7 of the worksheet on page D-8			
30 31	Multiply line 30 by 8% (.08)	31		
32	Subtract line 30 from line 28			
33	Multiply line 32 by 10% (.10)	33		
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.			
34	Enter the smaller of line 20 or line 23			
35	Enter the smaller of line 20 of line 23			
36	Subtract line 35 from line 34			
37	Multiply line 36 by 20% (.20)	37	390	
38	Add lines 25, 31, 33, and 37	38	12,740	
39	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	12,877	UC
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40	12,740	00
	and on Form 1040, line 42			

SALE OF STOCK

Answers to Exercises

(C) Katherine's Form 1040, lines 13 and 42

Lesson 12

12	Business income or (loss). Attach Schedule C or C-EZ	12		
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ □	13	1,950	00
14	Other gains or (losses). Attach Form 4797	14		

41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	41		
42	Tax (see page 33). Check if any tax is from a ☐ Form(s) 8814 b ☐ Form 4972	42	12,740 0	00
12	Alternative minimum tax (see page 24). Attack Form 6251	43	, i	

12-44 Lesson 12
PENSION EARNER

Lesson 13

SALE OF HOME

Introduction and Objectives

Introduction

This lesson generally discusses the tax rules that apply when a taxpayer sells his or her **main home** in 2002. The taxpayer's main home is the one in which he or she lives most of the time.

A taxpayer does not need to report the sale of his or her main home on his or her tax return if the gain on the sale is less than or equal to an **exclusion amount** (discussed later). Generally, if the taxpayer meets the **ownership and use tests** (discussed later), he or she can exclude any gain from income up to \$250,000 (\$500,000, if married filing jointly).

This lesson does not cover the sale of a main home used as rental property or partially for business. However, see sidebar on this page.

Objective

At the end of this lesson you will be able to determine the amount of gain a taxpayer may exclude if a primary residence is sold.

MAIN HOME

Only the gain from the sale of the taxpayer's main home is eligible for the rules discussed in this lesson. If a home that is not the taxpayer's main home is sold during the year, the gain generally will have to be reported as income. Any gain that must be reported as income is taxable gain and is reported on Schedule D (Form 1040), *Capital Gains and Losses*. Therefore, a clear understanding of what is, and what is not, an individual's main home is very important.

A **main home** is where the taxpayer lives most of the time. The home does not necessarily have to be a house. A houseboat, a mobile home, a cooperative apartment, or a condominium (house or apartment) may also qualify as a main home.

TAX TIPS

***** If a taxpayer sold a main home in 2002 that was used as rental property or partly for business, he or she must report the taxable gain on the sale of the home on his or her tax return. A taxpayer in this situation should be referred to a paid professional tax preparer. The taxpayer can also get Publication 523, Selling Your Home, for more information.

POTENTIAL PITFALLS



A taxpayer's main home is not necessarily a home that is owned by the taxpayer. A rental home may be a main home.

TAX TIPS *******

Taxpayers cannot choose which home to designate as their main home. Facts and circumstances determine which home is the main home.

If a taxpayer has more than one home, it is necessary to determine which home he or she lives in most of the time.

In many, if not most cases, the taxpayer owns a single home in which he or she lives all the time. It may seem easy to evaluate this situation, since it is not necessary to determine which home is the main home. However, you must be sure that the owner of a single home also meets the requirement of living in the home most of the time. If not, it cannot be considered the main home.

Never assume that the house sold during the year was the taxpayer's main home, even if the house was the only one owned by the taxpayer. Be sure to check that the house was, in fact, the individual's main home.

Example 1

Lucille owns a home in a Colorado ski area (the ski home). She stays at the ski home most weekends and spends the entire months of December, January, and February there. When she is not at the ski home, she lives in a four-room apartment that she rents in Denver. For over half the year, she lives in Denver. Lucille's main home is her rental apartment in Denver, because she lives there most of the time. This is so even though she does not own the apartment in Denver.

POTENTIAL PITFALLS



If there is a loss on the sale of a taxpayer's main home, the taxpayer cannot deduct it on his or her tax return.

GAIN ON SALE OF MAIN HOME

To figure the gain (or loss) on the sale of the taxpayer's main home, you must know the **selling price**, the **amount realized**, and the **adjusted basis**.

Selling price

The selling price is the total amount the taxpayer (seller) received for his or her main home. It includes money, all notes, mortgages, or other debts taken over by the buyer as part of the sale, and the fair market value of any other property or services that the seller received.

Form 1099-S

If the taxpayer received Form 1099-S, *Proceeds From Real Estate Transactions*, box 1 shows the date of sale (closing) and box 2 shows the **gross proceeds** received from the sale of his or her main home. (Exhibit 1 shows a blank Form 1099-S.) If the taxpayer can exclude the entire gain from a sale in 2002, the person responsible for closing the sale (for example, a real estate broker or settlement agent) generally will not have to report it on Form 1099-S.

Exhibit 1 Form 1099-S

	☐ CORR	ECT	ED (if checked)			
FILER'S name, street address, city, st		1	Date of closing	OMB No. 1545-0997		
		2	2 Gross proceeds	2002		oceeds From Real state Transactions
		1	\$	Form 1099-S		
FILER'S Federal identification number	TRANSFEROR'S identification number	3	Address or legal description			Copy B
TRANSFEROR'S name Street address (including apt. no.)						For Transferor This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other
City, state, and ZIP code		4	Transferor received or will re as part of the consideration		s	sanction may be imposed on you if this item is required to be
Account number (optional)		5		ax		reported and the IRS determines that it has not been reported.
Form 1099-S	(keep	for	your records)	Department of the T	reasury -	Internal Revenue Service

Amount realized

The amount realized is the selling price minus **selling expenses.**

Selling expenses

Selling expenses include commissions, advertising fees, legal fees, and loan charges paid by the seller, such as points (points were discussed in lesson 5).

Adjusted basis

While the taxpayer owned his or her main home, he or she may have made adjustments (increases or decreases) to the **basis**. This adjusted basis is used to figure gain or loss on the sale of the taxpayer's main home. For information on how to figure the home's adjusted basis, see *Basis* in Publication 523.

Amount of gain (or loss)

When you know the amount realized and the home's adjusted basis, you can figure the taxpayer's **gain or loss.** If the amount realized is more than the adjusted basis, the difference is a gain and the taxpayer may be able to exclude all or part of it. If the amount realized is less than the adjusted basis, the difference is a loss. A loss on the sale of the taxpayer's main home cannot be deducted.

TAX TIPS

 $\star\star\star\star\star\star\star\star$ Jointly owned home

If a taxpayer and his or her spouse sell their jointly owned home and file a joint return, they figure their gain or loss as one taxpayer.

Separate returns

If married taxpayers file separate returns, each of the spouses must figure his or her gain or loss according to his or her ownership interests in the main home. Each spouse's ownership interest is determined by state law.

Joint owners not married

If a taxpayer and a joint owner (other than his or her spouse) sell a jointly owned home, each of them must figure his or her own gain or loss according to his or her ownership interest in the home. Each of them applies the rules discussed in this lesson and in Publication 523 on an individual basis.

POTENTIAL PITFALLS



A taxpayer cannot exclude the part of any gain that is equal to any depreciation allowed or allowable for the business use of his or her home.

Refer a taxpayer who used his or her main home for business to a paid professional tax preparer.

Amount of Exclusion

A single homeowner can generally exclude up to \$250,000 of gain from the sale of a main home. A married couple can exclude up to \$500,000 if they meet all of the following conditions.

- 1. They filed a joint return.
- 2. Either spouse or both meet the ownership test.
- 3. Both individuals meet the use test.
- 4. Neither individual excluded gain in the 2 years before the current sale of the home (not counting any sales before May 7, 1997).

For married individuals filing jointly who do not qualify for the \$500,000 exclusion of gain on the sale of a home because they do not satisfy the two-year ownership test, two-year use test, and the prohibition on any other sale or exchange of a residence within the last two years, the limit on the amount of excludable gain should be calculated separately for each spouse. In that case, the maximum exclusion for the couple is equal to the sum of the exclusions to which the spouses would otherwise be entitled if they had not been married.

OWNERSHIP AND USE TESTS

The **exclusion** is allowed each time a taxpayer sells or exchanges his or her main home, but generally no more than once every 2 years. To be eligible, the property must have been:

- 1. Owned by the taxpayer for a combined period of at least 2 years out of a 5-year period ending on the date of sale (the ownership test).
- 2. Lived in as the taxpayer's main home for at least 2 years of that 5-year period (the use test).

Period of ownership and use

The required 2 years of ownership and use do not have to be continuous. The taxpayer meets the tests if the taxpayer can show that he or she owned and lived in the property as his or her main home for either 24 full months or 730 days during the 5-year period. Short temporary absences, even if the property is rented during those absences, are counted as periods of use.

Ownership and use tests can be met during different 2-year periods. However, a taxpayer must meet both tests during the 5-year period ending on the date of the sale.

Example 2

In 1994, Helen Jones lived in a rented apartment. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 1999. In 2000, Helen became ill and on April 14 of that year she moved in to her daughter's home. On July 10, 2002, while still living in her daughter's home, she sold her apartment.

Helen can exclude all the gain on the sale of her apartment because she met the ownership and use tests. Her 5-year period is from July 11, 1997, to July 10, 2002, the date she sold the apartment. She owned her apartment from December 1, 1999, to July 10, 2002 (over 2 years). She lived in the apartment from July 11, 1997 (the beginning of the 5-year period), to April 14, 2000 (over 2 years).

Reduced Exclusion

If the property was owned and used as a main home for less than 2 years, a taxpayer may be able to claim a reduced exclusion. If this situation applies to a taxpayer, use the worksheet in Publication 523 to figure how to claim the reduced exclusion.

Example 3

Amanda, who is single, bought her first home in August 2000. In December 2001, the company she worked for notified her that she would be transferred to another town by the end of 2002. She continued to live in the home until June 2002, when she sold it at a gain and moved to the new town. Amanda owned and lived in the home less than 2 years, so she does not meet the ownership and use tests. However, she qualifies to exclude the gain because she sold the home due to a change in place of employment.

PENSION EARNER

Exercise 1

John is single and sold his home in July 2002, for \$300,000. The amount he realized from the sale was \$297,500. His adjusted basis in the home was \$255,500. Assuming he meets the ownership and use tests,

- a. What is the amount of the gain?
- b. What is his exclusion amount?

Exercise 2

Tim owns two homes. One residence is located in St. Louis where he works and the other is located in a resort area approximately 100 miles away. Tim lives in his St. Louis home during the week (Monday through Friday) and travels to his weekend home for Saturday and Sunday. His office allows him to work from home so approximately 5 months of the year he works from his weekend home. Which home is his main home?

TAXWISE HINTS

If a gain on the sale of a main home must be reported on the taxpayer's Form 1040. Link to a Schedule D, enter the description of property, and complete the remaining entries annotated in red. The software will calculate the gain and carry the calculation to the Form 1040.

SALE OF HOME Answers to Exercises Lesson 13

\$42,000 (\$297,500 minus \$255,500) \$42,000 Exercise 1a. 1b.

His main home is the St. Louis residence Exercise 2.

▶▶ SUMMING UP THIS LESSON ◀◀

In this lesson you have learned about the simplified rules that apply to homeowners who sell or exchange their principal residence. For more information on the tax rules that apply on the sale of a main home, see Publication 523.

Lesson 14

Pensions

Introduction and Objectives

In this lesson, you will learn about *Pensions*.

After completing this lesson, you should be able to:

- **Figure** and **report** any taxable pension benefits.
- **Determine** if any part of retirement income is nontaxable.
- **List** the methods used to determine the tax-free portion of an annuity payment.
- **Compute** the taxable portion of a pension using the Simplified Method.
- **List** options for handling lump-sum distributions.
- **Explain** minimum distribution rules.
- **Distinguish** between taxable and nontaxable social security benefits.
- **Determine** if estimated tax payments are required.

Disability pension income. Generally, a taxpayer who retires on disability must report his or her pension or annuity as income.

A taxpayer who is 65 or older at the end of the tax year, or a taxpayer who is under 65, retired on permanent and total disability, and who received taxable disability income, may be able to claim the credit for the elderly or the disabled. The taxpayer must be a U.S. citizen or a resident to claim the credit.

Do not treat the following payments as disability income:

- **1.** Any payment received from a retirement plan that does not provide for disability retirement.
- **2.** Any lump-sum payment for accrued annual leave paid to a taxpayer who retires on disability. Treat these payments as salary.

SPECIAL POPULATIONS



Some taxpayers with retirement income may be eligible for the credit for the elderly or the disabled. See Lesson 15 for more information.

TAX TIPS ******* Form W-2 and Form

Form W-2 and Form 1099-R are included in the Tax Forms Booklet Appendix.

PERSON TO

Person -

Many taxpayers become upset because they do not understand the pension tax rules. Be considerate when probing for the information you need to complete the return. If the taxpayer cannot provide the required information, suggest that the former employer or annuity administrator be contacted. You may want to give the taxpayer a written list of questions that should be answered by the employer.

Reporting disability pension income. For reporting the tax-payer's disability pension income, disability payments are taxed as wages until the taxpayer reaches the *minimum retirement age* set by the employer. After the taxpayer reaches the minimum retirement age, disability payments are treated as pension income. Minimum retirement age is generally the earliest age at which the taxpayer may receive a pension whether or not disabled.

An employer may report disability income on Form W-2, Wage and Tax Statement. However, an employer may also report disability income on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. Enter disability income reported on Form W-2 on line 7 of either Form 1040 or Form 1040A.

If the employer reports disability income on Form 1099-R, Box 2a shows the taxable amount. Check to see if Box 7 (Distribution Code) shows the code number 3 (Disability). If Box 7 indicates that the taxpayer is receiving disability payments, then determine if the taxpayer has reached the minimum retirement age.

- 1. Until the taxpayer reaches the minimum retirement age, report the disability income as wages on line 7 of Form 1040 or Form 1040A.
- 2. After the taxpayer has reached the minimum retirement age, report the disability income as a taxable pension. If the disability payments are partially taxable, use lines 16a and 16b (Form 1040) or lines 12a and 12b (Form 1040A). If the payments are fully taxable, enter the taxable amount on line 16b or line 12b; do not make an entry on line 16a or line 12a.

Pensions and Annuities

Pensions and annuities provide cash payments, usually after a person has retired. The payments may be for life or for a fixed period of time. They may begin at retirement or at a specific age.

- A **pension** is generally a series of definitely determinable payments made to an employee or survivor (the beneficiary of a deceased employee's pension) after the employee retires from work. Payments are made regularly and are for past services with an employer.
- An **annuity** is a series of payments under a contract from an insurance company, a trust company, or an individual. Annuity payments are made at regular intervals over a period of more than one full year.

A pension is fully or partially taxable depending on whether the employee contributed to the pension plan. Employee contributions are "after-tax" amounts that the employee paid into the pension fund. The employer usually deducts the contributions

from wages and deposits them into the pension fund on behalf of the employee. Each year, the employee pays tax on the amount that he or she contributed that year. The employee's contributions are included in his or her Form W-2. Employee contributions are often referred to as the *cost* of the pension or as the *investment* in the annuity contract. For pensions discussed here, the employer will also have contributed to the pension fund.

Fully Taxable Pensions

Generally, if the taxpayer did not contribute to the cost of the pension plan, the pension benefits received are fully taxable. Military pensions are noncontributory and, therefore, fully taxable.

Partially Taxable Pensions and Annuities

If a taxpayer contributed to a pension plan while employed, part of the pension received is a return of the amounts contributed in earlier years and, therefore, is nontaxable. If the taxpayer has paid tax on the contribution (it was included in wages), the amount contributed is not taxed again when the pension is received.

If the taxpayer's annuity starting date is after November 18, 1996, he or she generally must use the Simplified Method to determine the taxable portion of his or her pension income.

The General Rule

Most taxpayers who are covered by a qualified retirement plan will no longer be eligible to use the General Rule for annuity payments received from the plan. However, if a taxpayer is 75 or over and his or her annuity starting date is after November 18, 1996, use the General Rule if the payments are guaranteed for at least 5 years. Use the Simplified Method if the payments are guaranteed for less than 5 years.

Using the General Rule, each pension payment from a nonqualified plan consists of two parts: (1) a tax-free return of the tax-payer's contribution and (2) the remaining taxable part. For each taxpayer, an **exclusion percentage** is figured. The exclusion percentage is the taxpayer's contribution to the pension plan divided by the taxpayer's expected total pension income. The annual pension income, before deductions for insurance premiums or income taxes, is multiplied by the exclusion percentage. The result is the tax-free part of the pension. The remaining amount of pension income is taxable. For a full explanation and the tables you need, get Publication 939, *General Rule for Pensions and Annuities*.

Once the tax-free amount is figured using the General Rule, it remains the same in future years, even if payments become larger. All increases in the installment payments, including cost of living increases, are fully taxable.

Tax Tips

Most taxpayers who retire in 2002 can no longer use the General Rule.
Unless the exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan.

TAX TIPS

***** If the taxpayer must use the General Rule for annuity payments received from a nonqualified plan (including a commercial annuity), tell the taxpayer to consult a paid professional tax preparer or get Publication 939. However, if the exclusion percentage has already been calculated for the taxpaver it can be used for all future returns.

If the annuity starting date was before 1987, the taxpayer will exclude from the taxable income the tax-free amount until the pension income ceases.

If the annuity starting date of an eligible taxpayer is during or after 1987, the tax-free amount is excluded from taxable income until the pension cost is recovered. Once the pension cost is recovered, all of the pension income is taxable. If the taxpayer (or the last annuitant) dies before recovering all of the pension cost, a miscellaneous itemized deduction on Schedule A (Form 1040) is allowed (not subject to the 2-percent-of-adjusted-gross-income limitation) for the unrecovered cost on his or her final income tax return filed for the year of death.

TAX TIPS

The annuity starting date is either the first day of the first period for which the taxpayer receives payment under the contract, or the date upon which the obligation under the contract becomes fixed, whichever comes later.

Tax Tips

Total pension
received, line 1
of the Simplified
Method Worksheet,
should be the pension income before
deductions such as
insurance premiums
and income tax.

TAX TIPS

On line 3 of the Simplified Method
Worksheet, enter
the number that
applies from either
Table 1 or Table 2.

The Simplified Method

If the taxpayer's annuity starting date is after November 18, 1996, he or she must use the Simplified Method to figure the taxable portion of his or her pension if he or she participated in a qualified plan.

The Simplified Method must be used only if:

- The annuity starting date is after July 1, 1986,
- The annuity payments are for either (a) the duration of the taxpayer's life, or (b) the duration of the lives of the taxpayer and his or her beneficiary,
- The pension or annuity payments are from a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity, **and**
- At the time the pension or annuity payments began, the taxpayer was under the age of 75 **or** was entitled to less than 5 years of guaranteed payments.

For pensions starting after December 31, 1986, the taxpayer will exclude the nontaxable pension amount until the pension cost is recovered. Once the pension cost is recovered, the entire pension income is taxable.

The method shown in Table 2 of the Simplified Method Worksheet is used to figure the tax-free portion of joint and survivor annuity payments from a qualified plan. Under this recovery method, you must combine the ages of the annuitants at the birthdays preceding the annuity starting date. Example 1 shows how the Simplified Method applies if the annuity is payable over the lives of more than one annuitant after 1997.

Example 1

Peter, age 65, receives retirement benefits under a joint and survivor annuity, to be paid over the joint lives of Peter and his wife, Mary, age 62. Peter's annuity starting date is January 1, 2002. He contributed \$31,000 to a qualified plan and did not receive any distributions before the annuity starting date. Peter receives monthly payments of \$1,200 and his tax-free

monthly amount is \$100. Mary will receive monthly survivor benefits of \$600 upon her husband's death. See Exhibit 1 for a completed Simplified Method Worksheet for Peter.

Use the Simplified Method for Peter because his annuity starting date is after November 18, 1996, and the payments are from a qualified plan. In addition, because his annuity starting date is after December 31, 1997, and his annuity is payable over the lives of more than one annuitant, you must combine his age with his wife's age in completing line 3 of the worksheet. Complete the worksheet as follows:

TAX TIPS ***** Once figured, the monthly exclusion amount remains the same even when the pension income increases.

Exhibit 1

Simplified Method Worksheet

	s 16a and 16b	Keep for Your Record
before Augus	e beneficiary of a deceased employee or form st 21, 1996, see Pub. 939 to find out if you a sion of up to \$5,000. If you are, include the e 2 below.	are entitled to a death
Note. If you had more than one partially taxable taxable parts on Form 1040, line 16b. Enter the	e pension or annuity, figure the taxable part total pension or annuity payments received i	of each separately. Enter the total of the in 2002 on Form 1040, line 16a.
 Enter the total pension or annuity payment line 16a. Enter your cost in the plan at the annuity sta Enter the appropriate number from Table 1 be was after 1997 and the payments are for yenter the appropriate number from Table 2 be Divide line 2 by the number on line 3. Multiply line 4 by the number of months for wilf your annuity starting date was before 19th amount on line 8. Otherwise, go to line 6. Enter the amount, if any, recovered tax free in 7. Subtract line 6 from line 2. 	rting date elow. But if your annuity starting date our life and that of your beneficiary, below 4. which this year's payments were made. 87, skip lines 6 and 7 and enter this in years after 1986 6.	31,000 31,200 1,200 0
8. Enter the smaller of line 5 or line 7		
8. Enter the smaller of line 5 or line 7	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or	enter this amount in this line instead
 Enter the smaller of line 5 or line 7. Taxable amount. Subtract line 8 from line 1. on Form 1040, line 16b. If your Form 1099- 	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or Table 1 for Line 3 Above	enter this amount on this line instead 9. 13,200
 Enter the smaller of line 5 or line 7. Taxable amount. Subtract line 8 from line 1. on Form 1040, line 16b. If your Form 1099- 	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or Table 1 for Line 3 Above	enter this amount in this line instead
8. Enter the smaller of line 5 or line 7 9. Taxable amount. Subtract line 8 from line 1. on Form 1040, line 16b. If your Form 1099-of the amount from Form 1099-R IF the age at annuity starting date	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or Table 1 for Line 3 Above AND your annuity before November 19, 1996,	enter this amount to this line instead 9. 13,200 starting date was— after November 18, 1996,
8. Enter the smaller of line 5 or line 7	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7 9. Taxable amount. Subtract line 8 from line 1. on Form 1040, line 16b. If your Form 1099-of the amount from Form 1099-R	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7	Enter the result, but not less than zero. Also, R shows a larger amount, use the amount or Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3 300 260 240 170	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3
8. Enter the smaller of line 5 or line 7 9. Taxable amount. Subtract line 8 from line 1, on Form 1040, line 16b. If your Form 1099-of the amount from Form 1099-R	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3 410
8. Enter the smaller of line 5 or line 7	Table 1 for Line 3 Above AND your annuity before November 19, 1996, enter on line 3	starting date was— after November 18, 1996, enter on line 3

TAX TIPS ****** Line 6 of the Simplified Method Worksheet can be more complicated than in Example 1. Line 6 is the total tax-free pension income recovered in previous years. It includes amounts excluded from taxable income after 1986. Get Pub. 17, Chapter 11, and Pub. 575 for more information and additional examples.

After Peter excludes \$31,000 from taxable income this year and in future years, the rest of his retirement benefits will be fully taxable. Because this is a joint and survivor annuity, if Peter dies before recovering all of the pension cost, his wife will also exclude \$100 from her \$600 monthly payment until the pension cost is fully recovered. If she dies before recovering all of the pension cost, the remaining unrecovered cost will be deducted on her final income tax return as a miscellaneous itemized deduction on Schedule A (Form 1040) (not subject to the 2-percent-of-adjusted-gross-income limitation).

If the taxpayer's annuity starting date was before November 19, 1996, (and he or she received payments in prior years), you do not need to recompute the tax-free monthly amount. Enter the monthly exclusion computed in prior years on line 4 of the worksheet. If the taxpayer did not keep a copy of the completed worksheet for 2001, use the recovery rates from Table 1 (line 3) of the Simplified Method Worksheet.

Note: The Simplified Method Worksheet is part of the 1099R input screen in the Taxwise® software. Scroll to the bottom of the input screen to see the worksheet.

Form 1099-R

Pension income is reported on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* Generally, the taxpayer's after-tax contributions to a profit-sharing or retirement plan that was recovered tax-free, this year, is shown in box 5 of Form 1099-R. A copy of Form 1099-R should be attached to Form 1040 or Form 1040A, if there is an entry in box 4 (Federal income tax withheld).

Reporting Pension Income

Total pension income is entered on either Form 1040, line 16a, or Form 1040A, line 12a. The taxable part is entered on Form 1040, line 16b, or on Form 1040A, line 12b. If the pension is fully taxable, enter it on Form 1040, line 16b, or Form 1040A, line 12b and leave Form 1040, line 16a, or Form 1040A, line 12a, blank. If the taxpayer has more than one pension or annuity that is not fully taxable, figure the taxable part of each separately. Enter only totals on the proper lines of Form 1040 and Form 1040A.

Tax Tips

When the taxpayer has more than one pension or annuity, use a separate piece of paper as a worksheet to group together detailed information. Only the summary information is entered on Form 1040 or Form 1040A. The worksheet should be kept for future reference.

POTENTIAL PITFALLS

Be sure to add the amounts shown on all Forms 1099-R as federal income tax withheld and enter the total on Form 1040, line 62, or on Form 1040A, line 39. The omission of pension withholding is a frequent error that results in an incorrect amount owed or refunded (and an unhappy taxpayer).

Exercise 1

George, age 65, began receiving pension income under a joint and survivor annuity. George's annuity starting date is January 1, 2002. George had contributed \$26,000 to a qualified plan and had received no distribution before 2002. George is to receive a monthly retirement benefit of \$1,000 and his wife, age 66, is to receive a monthly survivor benefit of \$500 upon George's death. Using the 2002 Form 1099-R for George, complete the Simplified Method Worksheet and Form 1040A, lines 12a and 12b.

Exhibit 2 George's Form 1099-R CORRECTED (if checked) PAYER'S name, street address, city, state, and ZIP code OMB No. 1545-0119 1 Gross distribution **Distributions From** Pensions, Annuities, ABC, Inc. Retirement or \$12,000 **Profit-Sharing** 2a Taxable amount Plans, IRAs, 1042 West 1st Street Insurance Form 1099-R Contracts, etc. Dayton, OH 45102 2b Taxable amount Total Copy B not determined distribution Report this income on your PAYER'S Federal identification RECIPIENT'S identification 3 Capital gain (included 4 Federal income tax Federal tax return. If this form shows 10-5432102 000-00-6218 -0-Federal income RECIPIENT'S name Employee contributions 6 Net unrealized tax withheld in appreciation in box 4, attach George E. Lopez employer's securities this copy to your return. \$ 26,000 7 Distribution Street address (including apt. no.) IRA/ 8 Other SEP/ SIMPLE code This information is 89 East Forest Avenue being furnished to the Internal City, state, and ZIP code 9a Your percentage of total 9b Total employee contributions Revenue Service. Dayton, OH 45440 distribution Account number (optional) 10 State tax withheld 11 State/Payer's state no. 12 State distribution \$ 13 Local tax withheld 14 Name of locality 15 Local distribution \$ \$ Form 1099-R Department of the Treasury - Internal Revenue Service

12a Pensions and	12b Taxable amount	
annuities. 12a	(see page 26). 12b	

Simplified Method Worksheet

Simplified Method Wor	ksheet—Lines 12a and 12b	Keep for Your Records
A	you are the beneficiary of a deceased employe ugust 21, 1996, see Pub. 939 to find out if you up to \$5,000. If you are, include the exclusion	are entitled to a death benefit exclusion
		taxable part of each separately. Enter the total of the nents received in 2002 on Form 1040A, line 12a.
 Enter your cost in the plan at Enter the appropriate number after 1997 and the paymen appropriate number from Tab Divide line 2 by the number of Multiply line 4 by the number annuity starting date was before Otherwise, go to line 6. Enter the amount, if any, reco Subtract line 6 from line 2. Enter the smaller of line 5 or Taxable amount. Subtract line Form 1040A, line 12b. If your 	the annuity starting date r from Table 1 below. But if your annuity starting tats are for your life and that of your beneficied 2 below. r from this are for your life and that of your beneficied 2 below. r of months for which this year's payments were to refer to 1987, skip lines 6 and 7 and enter this amovered tax free in years after 1986. line 7 the 8 from line 1. Enter the result, but not less the Form 1099-R shows a larger amount, use the amo	ting date was ary, enter the 3 4
	Table 1 for Line 3 Above	
IF the age at annuity	AND your annuity star	ting date was—
starting date (see page 28) was	before November 19, 1996, enter on line 3	after November 18, 1996, enter on line 3
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or older	120	160
	Table 2 for Line 3 Above	
IF the combined ages at any starting date (see page 28) v		er on line 3
110 or under		410
111–120		360
121–130		310
131–140		260
141 or older		210

Lump-sum Distributions

A **lump-sum distribution** is the distribution or payment within one tax year of an employee's entire balance (less deductible voluntary employee contributions and certain amounts forfeited or subject to forfeiture) from all qualified pension, stock bonus, or profit-sharing plans that the employer maintains. To qualify as a lump-sum distribution, the payment must have been made:

- Because the plan participant died, or
- After the participant reached age 59 1/2, or
- Because the participant (not including a self-employed individual) separated from service with the employer, or
- After the participant, if a self-employed individual, becomes totally and permanently disabled.

Lump-sum distributions are reported on Form 1099-R like any other pension distribution. Some lump-sum distributions qualify for special tax treatments. Code A in box 7 of the 1099-R indicates that it is a lump-sum distribution and it qualifies for special tax treatments such as:

- Distributions allocable to pre-1974 participation being taxed at a special rate (there will be an amount in box 3 of Form 1099-R) (The part after 1973 is ordinary income)
- Ten-year tax option of the distributions
- Tax-free rollover of the distribution into an Individual Retirement Arrangement (IRA).

Minimum Distributions

Taxpayers are required to receive **minimum distributions** from qualified employee retirement plans, qualified annuity plans, deferred compensation plans, tax-sheltered annuity plans and Individual Retirement Arrangements (IRAs) other than Roth IRAs.

Distributions must begin by April 1 of the calendar year that follows the calendar year in which the taxpayer reaches age 70 1/2 or retires, if later. (For IRAs, it does not matter whether the taxpayer is employed. Distributions must begin by April 1 of the year following the calendar year in which the taxpayer reaches age 70 1/2.) Required distributions for later years must be made by December 31 of that year.

Special Populations



Taxpayers may be subject to an additional tax when a distribution from certain pensions is taken before age 59 1/2. However, if all distributions received are rolled over, the 10% early distribution tax will not apply.

For example, people who are laid off may take a lump-sum distribution and be liable for a tax of 10% in addition to any income tax on the amount distributed.

Taxpayers in this situation should be referred to a paid professional tax preparer.

A minimum distribution is:

- The entire amount in the pension plan, or
- Regular periodic distributions in an amount large enough to use up the entire amount in the pension plan over:
 - 1. The taxpayer's life expectancy,
 - **2.** The joint life expectancies of the taxpayer and a designated surviving beneficiary, or
 - **3.** A shorter period of time than these life expectancies.

IMPORTANT! If the taxpayer does not receive the minimum distribution, an excise tax may be imposed. The tax is 50 percent of the difference between the minimum distribution and the amount actually distributed for the tax year.

TAXABLE SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

Part of the social security benefits or Part of the social security equivalent portion of tier 1 railroad retirement benefits a tax-payer receives may be taxable. The taxable amount, if any, depends upon the rest of the taxpayer's income and filing status. Many taxpayers that you assist will not have enough income for any of their benefits to be taxable.

Taxable Benefits

The taxable amount of benefits received is figured using the worksheet provided in the instruction booklets for Forms 1040 and 1040A.

The computation to figure the taxable amount is the same for both types of benefits.

1. Social Security Monthly Benefits

Social security benefits are payments made under Title II of the Social Security Act. They include old-age, survivors', disability, insurance, and some workers' compensation benefits.

Social security benefits are reported to the taxpayer on Form SSA-1099, *Social Security Benefit Statement* (see Exhibit 3.) The amount in box 5, *Net benefits for 2002*, is entered on a worksheet to figure if any of the benefits are taxable. Net benefits are the gross benefits less any repayments made by the taxpayer in the tax year. Make sure you enter only the amount from box 5 of Form SSA-1099 on line 1 of the worksheet.



Taxpayers may become upset when you question them about their social security benefits. They may insist that benefits are tax free. Use your effective communication skills to calm them. **Explain that some** benefits could be taxable, but vou must do the calculations before that can be determined.

Neither Form SSA-1099 nor the worksheet is attached to the income tax return. They are kept with the taxpayer's other personal records.

2. Railroad Retirement Benefits

Benefits paid under the Railroad Retirement Act fall into **two** categories. These categories are treated differently for income tax purposes.

The **first category** is the amount of tier 1 railroad retirement benefits that equals the social security benefit that a railroad employee or beneficiary would have been entitled to receive under the social security system. This part of the tier 1 benefit is called the "social security equivalent benefit" and is treated for tax purposes like social security benefits. It is shown on the blue part of the Form RRB-1099, *Payments by the Railroad Retirement Board*. Use the amount from box 5 of Form RRB-1099 to complete the worksheet.

The **second category** contains the rest of the tier 1 benefits, called the "non-social security equivalent benefit," any tier 2 benefits, vested dual benefits, and supplemental annuity benefits. This category of benefits, shown on the green part of the Form RRB-1099-R, *Annuities or Pensions by the Railroad Retirement Board*, is treated as an amount received from a qualified employer plan. Vested dual benefits and supplemental annuity benefits are fully taxable pensions. Publication 575, *Pension and Annuity Income* explains the items shown on the form.

Who Should Report?

Benefits, if taxable, are included in the income of the person with the legal right to receive them. Forms SSA-1099 and RRB-1099 will show this person's name. If a child receives benefits, the check may be in the parent's name. The benefits actually belong to the child, however, and are not reported on the parent's tax return.

Common Queries

If the taxpayer's only income was social security benefits, none of the benefits are taxable.

Example 2

Anne and her son, Tony, both receive survivor social security benefits. Anne receives a benefit check for \$400 each month. A portion of these benefits belongs to Tony. He was sent a Form SSA-1099, which showed \$1,800 of net benefits received. Tony also had \$4,000 income from a summer job and some interest income. When you prepare his tax return, you would complete a *Social Security Benefits Worksheet* for Tony to figure if any of his social security benefits are taxable.

When you complete Anne's tax return, you would include only the \$3,000 of her social security benefits on her worksheet to figure if any of her benefits are taxable.

If the taxpayer files a joint return, you must combine the income and benefits of both spouses when completing the worksheet.

Even if the spouse received no social security benefits, include the spouse's other income when completing the worksheet. If both spouses received benefits, combine both their benefits and income, and complete only one worksheet.

Example 3

Wanda and Dan are both retired and they file a joint return. Wanda received a Form SSA-1099 with an amount of \$4,300 appearing in box 5. Dan retired from the railroad, and box 5 of his Form RRB-1099 shows an amount of \$6,800. Wanda and Dan will use benefits of \$11,100 and only one worksheet to figure if any of their benefits are taxable.

Using the Social Security Benefits Worksheet

The *Social Security Benefits Worksheet* is found in the instruction booklets for Forms 1040 and 1040A. The worksheet is used to figure the taxable portion of benefits received.

Some of the benefits received are taxable if total income, plus one-half of the benefits received, is more than certain **base amounts.** The current base income amounts are:

- \$32,000 if married and filing a joint return
- \$25,000 if taxpayer is filing as single, head of household, or qualifying widow(er) with dependent child
- \$25,000 if married but filing separately, and the taxpayer **did not** live with his or her spouse at any time during 2002
- \$0 if married filing separately, and the taxpayer **did** live with his or her spouse at any time during 2002

SPECIAL POPULATIONS



The Social Security Benefits Work-sheet is not used for taxpayers who are nonresident aliens. Special tax rules apply to their benefits, and they should consult a paid professional tax preparer.

TAX TIPS

A copy of a Social
Security Benefits
Worksheet for Form
1040 is included in
the IRS Volunteer
Quick Reference
Guide, which is part
of your Publication
678 Package.

Report taxable social security benefits on Form 1040, line 20b, or Form 1040A, line 14b. Complete the other income and adjustment items on page 1 of Form 1040 or Form 1040A before you use the *Social Security Benefits Worksheet*. Then complete the other lines of the worksheet to figure if any of the benefits are taxable.

If the worksheet shows that no benefits are taxable, leave the line blank for social security benefits on Form 1040 or Form 1040A. Then total page 1 and complete the remainder of the tax return.

If you determine that any benefits are taxable, complete line 20 of Form 1040 or line 14 of Form 1040A. Enter the social security benefits received on Form 1040, line 20a, and enter the taxable portion (from line 18 of the worksheet) on line 20b. On Form 1040A, enter the benefits received on line 14a, and enter the taxable portion of benefits on line 14b.

The taxable portion of social security benefits is never more than 85 percent of the net benefits the taxpayer has received. In many cases, the taxable portion is less than 50 percent.

Example 4

Ray and Susan are married and file a joint Form 1040. Ray is retired and receives a fully taxable pension of \$12,000 (Form 1040, line 16b). Ray received a \$3,000 short-term capital gain from the sale of stock. He must file a Schedule D to report the gain. Ray also receives social security benefits. His Form SSA-1099 is shown in Exhibit 3. Susan worked and earned wages of \$21,500 (Form 1040, line 7) in 2002. She also contributed \$560 to her traditional IRA (Form 1040, line 23). Susan is not covered at work by a pension plan. Ray and Susan's completed *Social Security Benefits Worksheet* is shown in Exhibit 4.

Exhibit 5 shows Ray and Susan's Form 1040 for 2002. The amount from line 1 of the worksheet is entered on line 20a of Form 1040. Then the taxable benefits (\$3,050) from line 18 of the worksheet is entered on line 20b.

TAX TIPS

When completing line 1 of the worksheet, be sure to use the amount from box 5, *Net Benefits*, on Form SSA-1099 or Form RRB-1099. Do not enter the amount from box 3.

Special Populations



Certain taxpayers may have to include up to 85% of their total net benefits from social security and equivalent railroad retirement in taxable income.

Exhibit 3 Ray's Form SSA-1099

FORM SSA-1099 - SOCIAL SECURITY BENEFIT STATEMENT • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME. SEE THE REVERSE FOR MORE INFORMATION. Box 1. Name Box 2. Beneficiary's Social Security Number Ray Hess 000-00-6735 Box 5. Net Benefits for 2002 (Box 3 minus Box 4) Box 3. Benefits Paid in 2002 Box 4. Benefits Repaid to SSA in 2002 6,100.00 6.100.00 **DESCRIPTION OF AMOUNT IN BOX 3 DESCRIPTION OF AMOUNT IN BOX 4** 0491 Box 6. Voluntary Federal Income Tax Withholding Box 7. Address 1234 Main St. Wilton, FL 10123 Box 8. Claim Number (Use this number if you need to contact SSA.)

DO NOT RETURN THIS FORM TO SSA OR IRS

Form SSA-1099-SM (1-2002)

Jocial Security Bellenit	ts Worksheet—Lines 20a and 20b	Keep fo	r Your Record
Before you begin:	√ Complete Form 1040, lines 21, 23, 24, and 27 throug to you.		
	√ Figure any amount to be entered on the dotted line n page 30).	ext to line 34 (see	
	√ If you are married filing separately and you lived ap for all of 2002, enter "D" to the right of the word "be		
	√ Be sure you have read the Exception on page 25 to sworksheet instead of a publication to find out if any taxable.		s
	t from box 5 of all your Forms SSA-1099 and	,100	
	1	2	3,050
3. Add the amounts on F	Form 1040, lines 7, 8a, 9 through 14, 15b, 16b, 17 through tts from box 5 of Forms SSA-1099 or RRB-1099	19, and 21.	36,500
	ny, from Form 1040, line 8b		- 0 -
			39,550
6. Add the amounts on Fo	orm 1040, lines 23, 24, and 27 through 33a, and any amount	you entered	
	t to line 34	6	560
7. Is the amount on line	6 less than the amount on line 5?		
No. (STOP) None of	your social security benefits are taxable.		
X Yes. Subtract line	6 from line 5	7.	38,990
and you lived apart fr	e, head of household, qualifying widow(er), or married filing from your spouse for all of 2002; \$32,000 if married filing ately and you lived with your spouse at any time in 2002.	jointly; -0-	32,000
9. Is the amount on line	8 less than the amount on line 7?		
amounts separate line 20t line 20a		arried filing enter -0- on penefits" on	
	8 from line 7		6,990
	rom your spouse for all of 2002; \$12,000 if married filing		10.000
~ ^	ately and you lived with your spouse at any time in 2002. line 9. If zero or less, enter -0		12,000 - 0 -
	ine 9 or line 10.		6,990
13. Enter one-half of line			3,495
	ine 2 or line 13		3,050
15. Multiply line 11 by 85	5% (.85). If line 11 is zero, enter -0	15	- 0 -
			3,050
* *	% (.85)		5,185
	ty benefits. Enter the smaller of line 16 or line 17	18	3,050
• Enter the amount from	om line 1 above on Form 1040, line 20a.		

l	7	Wages, salaries, tips, etc. Attach Form(s) W-2	7		
Income	8a	Taxable interest. Attach Schedule B if required	8a		
Attach	b	Tax-exempt interest. Do not include on line 8a 8b			
Forms W-2 and	9	Ordinary dividends. Attach Schedule B if required	9		
W-2G here. Also attach	10	Taxable refunds, credits, or offsets of state and local income taxes (see page 22)	10		
Form(s) 1099-R	11	Alimony received	11		
f tax was	12	Business income or (loss). Attach Schedule C or C-EZ	12		
withheld.	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ □	13		
	14	Other gains or (losses). Attach Form 4797	14		
If you did not	15a	IRA distributions 15a b Taxable amount (see page 23)	15b		
get a W-2,	16a	Pensions and annuities 16a b Taxable amount (see page 23)	16b		
see page 21.	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17		
Enclose, but do	18	Farm income or (loss). Attach Schedule F	18		
not attach, any	19	Unemployment compensation	19		
payment. Also, please use	20a	Social security benefits 20a 6,100 00 b Taxable amount (see page 25)	20b	3,050	00
Form 1040-V.	21	Other income. List type and amount (see page 27)	21	·	
	22	Add the amounts in the far right column for lines 7 through 21. This is your total income	22		
	23	Educator expenses (see page xx)			
Adjusted	24	IRA deduction (see page 27)			
Gross	25	Student loan interest deduction (see page 28)			
Income	26	Tuition and fees deduction (see page XX)			
	27	Archer MSA deduction. Attach Form 8853 27			
	28	Moving expenses. Attach Form 3903			
	29	One-half of self-employment tax. Attach Schedule SE . 29			
	30	Self-employed health insurance deduction (see page 30)			
	31	Self-employed SEP, SIMPLE, and qualified plans 31			
	32	Penalty on early withdrawal of savings			
	33a	Alimony paid b Recipient's SSN ▶			
	34	Add lines 23 through 33a	34		
	35	Subtract line 34 from line 22. This is your adjusted gross income	35		

Exercise 2

Steve Ransom and his wife separated in July and Steve moved into an apartment. They are still legally married, but they are filing separate returns. Steve's Form 1040A shows income of \$18,975 (wages) before considering his social security benefits. He has no tax-exempt interest income and no adjustments to income. Steve's Form SSA-1099 is shown in Exhibit 6.

- A. Complete Steve's Social Security Benefits Worksheet, Exhibit 7.
- B. Complete lines 7 through 18 of Steve's Form 1040A, Exhibit 8.

Exhibit 6 Steve's Form SSA-1099

FORM SSA-1099 - SOCIAL SECURITY BENEFIT STATEMENT • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME. SEE THE REVERSE FOR MORE INFORMATION. Box 2. Beneficiary's Social Security Number Box 1. Name Steve Ransom 000-00-4356 Box 3. Benefits Paid in 2002 Box 5. Net Benefits for 2002 (Box 3 minus Box 4) Box 4. Benefits Repaid to SSA in 2002 8,250.00 8,250.00 **DESCRIPTION OF AMOUNT IN BOX 4 DESCRIPTION OF AMOUNT IN BOX 3** Box 6. Voluntary Federal Income Tax Withholding Box 7. Address 1234 Main St. Wilton, FL 10123 Box 8. Claim Number (Use this number if you need to contact SSA.) Form SSA-1099-SM (1-2002) DO NOT RETURN THIS FORM TO SSA OR IRS

		,
efore you begin:	\surd Complete Form 1040A, lines 16 and 17, if it applies to you.	
	√ If you are married filing separately and you lived apart from your enter "D" to the right of the word "benefits" on line 14a.	spouse for all of 2002,
	√ Be sure you have read the Exception on page 30 to see if you can instead of a publication to find out if any of your benefits are taxab	
1. Enter the total amount fr	om box 5 of all your Forms SSA-1099 and Forms RRB-1099 1.	
2. Is the amount on line 1	more than zero?	
No. STOP None of	f your social security benefits are taxable.	
Yes. Enter one-half	of line 1	2.
	Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include among or RRB-1099	
	y, from Form 1040A, line 8b	
	~ · · · · · · · · · · · · · · · · · · ·	
	rm 1040A, lines 16 and 17	
	less than the amount on line 5?	
No. STOP None of	f your social security benefits are taxable.	
Yes. Subtract line 6	from line 5	7.
	, head of household, qualifying widow(er), or married filing separately and you li of 2002; \$32,000 if married filing jointly; -0- if married filing separately and time in 2002	d you lived
Is the amount on line 8	less than the amount on line 7?	
or 14b spouse	f your social security benefits are taxable. You do not have to enter any amount of Form 1040A. But if you are married filing separately and you lived apart for all of 2002, enter -0- on line 14b. Be sure you entered "D" to the right of the sure of the sure you entered be a sure yo	from your
Yes. Subtract line 8	from line 7	9.
6. Enter: \$9,000 if single, from your spouse for all with your spouse at any	head of household, qualifying widow(er), or married filing separately and you led of 2002; \$12,000 if married filing jointly; -0- if married filing separately and time in 2002.	d you lived
Subtract line 10 from li		
	ne 9. If zero or less, enter -0	11.
	ine 9. If zero or less, enter -0	
. Enter the smaller of lin	ne 9 or line 10	
Enter the smaller of line 1.	ne 9 or line 10	12.
Enter the smaller of lin Enter one-half of line 1 Enter the smaller of line	ne 9 or line 10	12. 13. 14.
Enter the smaller of line 1. Enter one-half of line 1. Enter the smaller of line. Multiply line 11 by 85%	ne 9 or line 10	12
Enter the smaller of line 1 Enter one-half of line 1 Enter the smaller of line Multiply line 11 by 859 Add lines 14 and 15	ne 9 or line 10	12
 Enter the smaller of lin Enter one-half of line 1 Enter the smaller of lin Multiply line 11 by 859 Add lines 14 and 15 Multiply line 1 by 85% 	ne 9 or line 10	12
2. Enter the smaller of line 1 3. Enter one-half of line 1 4. Enter the smaller of line 5. Multiply line 11 by 85% 6. Add lines 14 and 15 . 7. Multiply line 1 by 85% 7. Multiply line 1 by 85% 7. Taxable social security	2	12

Income					
Attach	_7	Wages, salaries, tips, etc. Attach Form	m(s) W-2.	7	
Form(s) W-2 here. Also attach		Taxable interest. Attach Schedule 1 it Tax-exempt interest. Do not include on lir		8a	
Form(s)	9	Ordinary dividends. Attach Schedule 1		9	
1099-R if tax was withheld.	10	Capital gain distributions (see page 2	•	10	
If you did not get a W-2, see page 25.	11a		11b Taxable amount (see page 25).	11b	
Enclose, but do not attach, any	12a	Pensions and annuities. 12a	12b Taxable amount (see page 26).	12b	
payment.	<u>13</u>	Unemployment compensation and Ala	13		
	14a ——	Social security benefits. 14a	14b Taxable amount (see page 28).	14b	
	15	Add lines 7 through 14b (far right colum	nn). This is your total income.	▶ 15	
Adjusted	16	Educator expenses (see page XX).	16		
gross	17	IRA deduction (see page 28).			
income	18	Student loan interest deduction (see pa			
income	19	Tuition and fees deduction (see page X	<u> </u>		
	20	Add lines 16 through 19. These are year	our total adjustments.	20	
	21	Subtract line 20 from line 15. This is yo	ur adjusted gross income.	▶ 21	
For Disclosure.	Privacv	Act, and Paperwork Reduction Act Noti	ice, see page 53. Cat. No. 1132	7A Form 1040A (2002

POTENTIAL PITFALLS



Taxable social security benefits cannot be reported on Form 1040EZ.

POTENTIAL PITFALLS



A lump-sum death benefit is not subject to tax. Taxable social security benefits cannot be reported on Form 1040EZ. The taxpayer must use Form 1040 or Form 1040A if any benefits are taxable. If the completed worksheet shows that no benefits are taxable, the taxpayer may be able to use the shorter Form 1040EZ. There are, however, some situations that prevent taxpayers who do not have any taxable social security benefits from using the shorter Form 1040EZ.

Lump-Sum Benefit Payments

Some taxpayers may have received a **lump-sum benefit payment** in 2002. This payment could be for both the current tax year and the prior tax year. The lump-sum payment will be included in box 3 of the Form SSA-1099 or Form RRB-1099 that the taxpayer receives. The form will also show the year, or years, of the payment.

When figuring the taxable portion of social security benefits, two options are available for lump-sum benefit payments. The first option allows the taxpayer to report the whole payment in 2002, the year it was received. When the taxpayer chooses this option, complete the *Social Security Benefits Worksheet* as usual by including the entire lump-sum payment on line 1.

The taxpayer also has the option of treating the payment as received in the earlier year or years. This is done by figuring whether any part of these benefits is taxable, based on the earlier year's income. Any part that is taxable is then added to any taxable benefits for the current year (2002) and included on Form 1040, line 20b.

If the taxpayer chooses to spread the payments back to earlier years, only 2002 income will be adjusted. The taxpayer does not file amended returns for the earlier years. However, a special procedure *must* be used to figure the taxable portion of the benefits assigned to the earlier years. If the taxpayer wants to use this option, refer him or her to a paid professional tax preparer or to IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.

Distributions from Individual Retirement Arrangements

A taxpayer establishes an **individual retirement arrangement** (**IRA**) and makes *contributions* to it through a bank, credit union, brokerage, or other entity approved by the IRS. Earnings and gains generally accumulate tax free until they are withdrawn as either taxable, non-taxable or partly taxable *distributions*. There are four kinds of IRAs, each of which offer tax advantages.

As a volunteer, you will be able to complete the return of a taxpayer who received a distribution from an IRA only if the whole distribution is either tax free or taxable as a normal distribution. If part is taxable and part is tax free, refer the taxpayer to a paid professional tax preparer.

For further information about IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

Traditional IRA. If the taxpayer made nondeductible contributions into the IRA, he or she need not pay income tax on those contributions again when receiving them later as part of a distribution from the traditional IRA. The taxpayer does have to pay tax on the part of traditional IRA distributions that represent either earnings that accumulated tax free in the traditional IRA or contributions that were deducted when the taxpayer paid them into the traditional IRA.

The taxpayer cannot withdraw only nondeductible contributions from a traditional IRA; if there have been any earnings or gains on contributions or deductible contributions have been made to any traditional IRA, part of each distribution will be taxable.

Example 5

Tyrone contributed \$500 a year to a traditional IRA. Each year he deducted his traditional IRA contribution from his income. This year he received his first distribution from the traditional IRA. It is fully taxable. Tyrone will pay income tax on the distributions he receives which represent the contributions he made and deducted as well as the money the contributions have earned over the years.

Example 6

Dorothy contributed \$750 a year to a traditional IRA. She did not qualify to deduct her contributions from her income. This year she received her first distribution from the traditional IRA. She will pay income tax only on the part of the distribution from the traditional IRA that represents earnings on the contributions.

Savings Incentive Match Plans for Employees (SIMPLE) IRA. Some employers offer their employees, including a self-employed individual, the chance to contribute part of their pay to an IRA as part of a SIMPLE plan. The employer is also generally required to make contributions on behalf of eligible employees. The employee is not currently taxed on his or her contributions when they are paid into the IRA. Distributions from a SIMPLE IRA are generally fully taxable.

Simplified Employee Pension (SEP) IRA. Some employers offer their employees the chance to take part in a SEP. Self-employed people also can establish a SEP-IRA for themselves. Generally, SEP-IRA contributions are not included in an employee's income when paid into the IRA. Distributions are generally fully taxable when the employee receives them in later years.

Roth IRA. Contributions to a Roth IRA are not deductible. Distributions from a Roth IRA are tax free if they meet certain conditions, even if they represent earnings that accumulated in the Roth IRA.

Reporting IRA Distributions

IRA distributions are reported on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

Traditional IRA, SIMPLE IRA, or SEP-IRA: Box 7 of Form 1099-R shows "7" as the distribution code for a normal distribution, and the box "IRA/SEP/SIMPLE" is checked. Ask the tax-payer whether he or she deducted all traditional IRA contributions from income in the year they were made. If so, the entire distribution is taxable. Report it on Form 1040A, lines 11a and 11b, or on Form 1040, lines 15a and 15b. Distributions from a SIMPLE IRA and from a SEP-IRA are generally fully taxable.

POTENTIAL PITFALLS



Not all taxpayers know how much of their IRA distribution is taxable. Form 1099-R may show the same amount in box 1. Gross distribution, and box 2a. Taxable amount, even if part of the distribution is nontaxable. Or box 2a. may be blank with a check mark in box 2b. Taxable amount not determined. If you cannot tell that all of a distribution is taxable, or that all of it is tax free, refer the taxpayer to a paid professional tax preparer.

Refer the taxpayer to a paid professional tax preparer if the taxpayer either:

- Cannot tell you whether all traditional IRA contributions were deducted or excluded from income in the year they were made, or
- Did not deduct all traditional IRA contributions from income in the year they were made, and they were not otherwise excluded from income that year. Only part of the distribution is taxable now. The taxable part must be computed.

Note: A traditional IRA is any IRA that is not a ROTH, or SIMPLE IRA.

Roth IRA. Form 1099-R shows "J" in box 7. The taxable and tax-free amounts must be computed. Refer the taxpayer to a paid professional tax preparer.

Withdrawal of Excess Contributions

If the taxpayer withdraws excess contributions and any earnings by the due date of the return, he or she will not be subject to an additional 6% tax on the excess contribution. The withdrawal must be completed by the due date of the tax return for that year, including extensions.

The withdrawn excess contribution is not included in the taxpayer's gross income if both of the following conditions are met.

- 1) No deduction was allowed for the excess contribution.
- 2) All interest or other income earned on the excess contribution is withdrawn.

However, the taxpayer must include in his or her gross income the interest or other income that was earned on the excess contribution. Report it on the return for the year in which the excess contribution was made. The withdrawal of interest or other income may be subject to an additional 10% tax on early withdrawals.

Taxpayers will receive Form 1099-R indicating the amount of the withdrawal. If the excess contribution was made in a previous tax year, the form will indicate the year in which the earnings are taxable.

In general, a taxpayer must include all withdrawals from his or her traditional IRA in gross income. However, if the total contributions to an IRA (other than rollover contributions for the year) are \$3,000 or less (\$3,500 or less if taxpayer is age 50 or older), and there are no employer contributions for the year, the taxpayer can withdraw any excess contribution after the due date for filing the tax return for that year, including extensions, and not include the amount withdrawn in his or her gross

TAX TIPS

***** There is a 10% additional tax on premature distributions (early withdrawals) from a traditional IRA. However, this additional tax will not apply to distributions up to the amount taxpayers pay for unreimbursed medical expenses that exceed 7.5% of their adjusted gross income.

Under certain conditions, the 10% additional tax will also not apply to distributions up to the amount paid for medical insurance for the taxpaver, his or her spouse and his or her dependents. The 10% additional tax also does not apply to distributions from a traditional IRA used to pay qualified higher education expenses or to buy, build, or rebuild a main home. For more information, see Publication 590.

income. This applies only to the part of the excess for which the taxpayer did not take a deduction. For more information on excess contributions, see Publication 590.

Pension Withholding and Estimated Tax Payments

Income tax is normally withheld from the taxable part of a pension or annuity. At the taxpayer's request, the payer of the pension or annuity can adjust the withholding amount or stop the withholding completely. However, an exemption from withholding generally may not be permitted for payments made outside the United States or its possessions.

A taxpayer who chooses not to have tax withheld may have to pay estimated tax. For more information about estimated tax or withholding, see Lesson 7 and Publication 505, *Tax Withholding and Estimated Tax*.

COMMON QUERIES

Use Form W-4P,
Withholding
Certificate for
Pension or Annuity
Payments, to change
the amount of
income tax to be
withheld.

▶▶ SUMMING UP THIS LESSON ◀◀

- ▶ Pensions or annuities may have a tax-free portion if the taxpayer made after-tax contributions to the plan.
- ➤ To determine the taxable portion of the annuity payments of a taxpayer, use:
 - **a.** The Simplified Method if the taxpayer's annuity starting date is after November 18, 1996, and annuity payments are from a qualified plan. For annuity starting dates after 1997, use the annuitant's age (or combined ages if more than one annuitant) at the annuity starting date of the taxpayer(s).
 - **b.** The General Rule for annuity payments from a nonqualified plan and for certain retirees age 75 or older.
- ➤ Total pension or annuity income and taxable pension or annuity income are entered on Form 1040, lines 16a and 16b, or Form 1040A, lines 12a and 12b.
- ➤ Social security Nontaxable or taxable
 To determine taxable portion of social security payments
 received by a taxpayer, use: Social Security Benefits
 Worksheet.
- ➤ Total social security income and taxable portion are entered on Form 1040, lines 20a and 20b, or Form 1040A, lines 14a and 14b.
- ➤ Federal income tax on pension, annuity and social security income can be withheld by the payer, or the taxpayer may choose to pay estimated tax.

PENSIONS Answers to Exercises

Exercise 1 George's Worksheet

Simplified Method Worksheet—Lines 12a and 12b

Keep for Your Records

Before you begin: If you are

Lesson 14

If you are the beneficiary of a deceased employee or former employee who died **before** August 21, 1996, see Pub. 939 to find out if you are entitled to a death benefit exclusion of up to \$5,000. If you are, include the exclusion in the amount entered on line 2 below.



Note. If you had more than one partially taxable pension or annuity, figure the taxable part of each separately. Enter the total of the taxable parts on Form 1040A, line 12b. Enter the total pension or annuity payments received in 2002 on Form 1040A, line 12a.

1.	Enter the total pension or annuity payments received in 2002. Also, enter this amount on Form 1040A, line 12a .	1	12,000.00
2.	Enter your cost in the plan at the annuity starting date		
3.	Enter the appropriate number from Table 1 below. But if your annuity starting date was		
	after 1997 and the payments are for your life and that of your beneficiary, enter the		
	appropriate number from Table 2 below		
4.	Divide line 2 by the number on line 3		
5.	Multiply line 4 by the number of months for which this year's payments were made. If your		
	annuity starting date was before 1987, skip lines 6 and 7 and enter this amount on line 8.		
	Otherwise, go to line 6		
6.	Enter the amount, if any, recovered tax free in years after 1986 6O		
7.	Subtract line 6 from line 2		
8.	Enter the smaller of line 5 or line 7	8	1,200.00
9.	Taxable amount. Subtract line 8 from line 1. Enter the result, but not less than zero. Also, enter this amount on		
	Form 1040A, line 12b. If your Form 1099-R shows a larger amount, use the amount on this line instead of the amount		
	from Form 1099-R	9	10,800.00

Table 1 for Line 3 Above

	Table I for Line o Above					
IF the age at annuity	AND your annuity starting date was—					
starting date (see page 28) was	before November 19, 1996, enter on line 3	after November 18, 1996, enter on line 3				
55 or under	300	360				
56–60	260	310				
61–65	240	260				
66–70	170	210				
71 or older	120	160				

Table 2 for Line 3 Above

IF the combined ages at annuity starting date (see page 28) were	THEN enter on line 3
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

George's Form 1040A

		<u>-</u>			
12a Pensions annuities	12,000	12b Taxable amount (see page 26).	12b	10,800	

3e	fore you begin: √ Complete Form 1040A, lines 16 and 17, if it applies to you.		
	√ If you are married filing separately and you lived apart from your spouse enter "D" to the right of the word "benefits" on line 14a.	for all of	f 2002,
	√ Be sure you have read the Exception on page 30 to see if you can use this instead of a publication to find out if any of your benefits are taxable.	workshe	eet
1.	Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099 1. 8,250.	00	
2.	Is the amount on line 1 more than zero?		
	(STOP)		
	No. None of your social security benefits are taxable.		4 105 (
	X Yes. Enter one-half of line 1	. 2.	4,125.0
	Add the amounts on Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts fr box 5 of Forms SSA-1099 or RRB-1099	. 3.	18,975.0
4.	Enter the amount, if any, from Form 1040A, line 8b	. 4.	07.100.0
	Add lines 2, 3, and 4		23,100.0
6.	Add the amounts on Form 1040A, lines 16 and 17	. 6.	
7.	Is the amount on line 6 less than the amount on line 5?		
	No. STOP None of your social security benefits are taxable.		
	▼ Yes. Subtract line 6 from line 5	. 7.	23,100.0
8.	Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived ap from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you li	art ved	
	with your spouse at any time in 2002	. 8.	
9.	Is the amount on line 8 less than the amount on line 7?		
	No. Stop None of your social security benefits are taxable. You do not have to enter any amount on line or 14b of Form 1040A. But if you are married filing separately and you lived apart from y spouse for all of 2002, enter -0- on line 14b. Be sure you entered "D" to the right of the w "benefits" on line 14a.	our	
	X Yes. Subtract line 8 from line 7	. 9.	23,100.0
).	Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived ap from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you li with your spouse at any time in 2002	ved	
1.	Subtract line 10 from line 9. If zero or less, enter -0		
	Enter the smaller of line 9 or line 10	. 12.	
3.	Enter one-half of line 12	. 13.	
4.	Enter the smaller of line 2 or line 13	. 14.	
5.	Multiply line 11 by 85% (.85). If line 11 is zero, enter -0	. 15.	19,635.0
5.	Add lines 14 and 15	. 16.	19,635.0
7.	Multiply line 1 by 85% (.85)	. 17.	7,013.0
3.	Taxable social security benefits. Enter the smaller of line 16 or line 17		7,013.0
	• Enter the amount from line 1 above on Form 1040A, line 14a.		
	• Enter the amount from line 18 above on Form 1040A, line 14b.		

Exercise 2 (B)

Steve's Form 1040A

D)				Steve S Form 104			
Income	Wages, salaries, tips, etc. Attach For	m(s) W-2.	7	18,975 00			
Form(s) W-2	trach prm(s) W-2 Control of the state of t						
attach	b Tax-exempt interest. Do not include on lir	ne 8a. 8b					
Form(s)	Ordinary dividends. Attach Schedule 1	if required.	9				
1099-R if tax		·					
was withheld. 10	Capital gain distributions (see page 2	25).	10				
get a W-2, see	a IRA distributions. 11a	11b Taxable amount (see page 25).	11b				
page 25. Enclose, but do not attach, any	a Pensions and annuities. 12a	12b Taxable amount (see page 26).	12b				
payment.	Unemployment compensation and Al	s. 13					
14	a Social security benefits. 14a 8,250 00	14b Taxable amount (see page 28).	14b	7,013 00			
15	Add lines 7 through 14b (far right colun	nn). This is your total income.	▶ 15	25,988 00			
Adjusted 16	Educator expenses (see page XX).	16					
gross 17	IRA deduction (see page 28).	17					
income $\frac{18}{18}$	Student loan interest deduction (see pa	age 31). 18					
19	Tuition and fees deduction (see page X	X). 19					
20	Add lines 16 through 19. These are y	our total adjustments.	20				
2-	Subtract line 20 from line 15. This is yo	our adjusted gross income.	▶ 21	25,988 00			
For Disclosure, Priva	cy Act, and Paperwork Reduction Act Not	ice, see page 53. Cat. No. 113	327A	Form 1040A (200			

		ENT NOTES	
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CREDIT FOR THE ELDERLY OR THE DISABLED

Lesson 15

Introduction and Objectives

In this lesson, you will learn about the credit for the elderly or the disabled.

After completing this lesson you should be able to:

■ **Figure** and **claim** the credit for the elderly of the disabled using Schedule R, Form 1040 or Schedule 3, Form 1040A.

TAX TIPS

Schedule R (Form
1040) is included in
the Tax Forms
Booklet Appendix.

SPECIAL POPULATIONS



Certain work offered at qualified locations to persons with disabilities or with mental retardation is considered sheltered employment. Because a person has accepted sheltered employment is not proof of the person's ability to engage in substantial gainful activity.

ALERT



Although physician statements are no longer required to be attached to the return, they must be completed and kept with the taxpayer's records.

CREDIT FOR THE ELDERY OR THE DISABLED

Elderly individuals and individuals who are permanently and totally disabled may be able to claim a special credit on their tax returns if they are a U.S. citizen or resident. To be eligible for the credit, an individual must be:

- At least 65 years old by the end of the year, or
- Under age 65, retired on permanent and total disability by the end of the year and did not reach mandatory retirement age before this year. They must also have received taxable disability income for this year.

Many elderly taxpayers are not eligible for this credit because of the income limitations. Here, we will cover the basics of determining who is eligible.

Exhibit 1 helps to determine if the taxpayer is a qualified individual for this credit. Also, taxpayers cannot exceed the income limits for their filing status (see **Exhibit 2**).

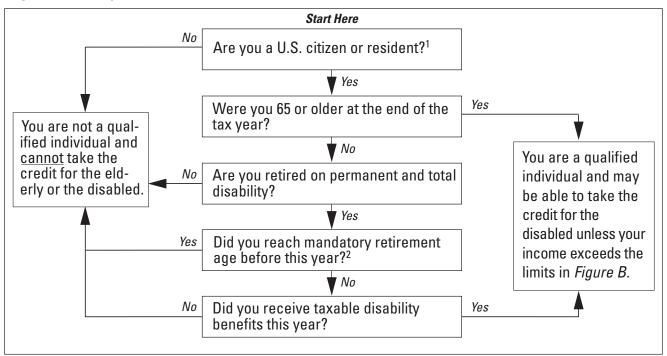
If the taxpayer is a qualified individual and meets the income limits, complete a Schedule 3 for 1040A filers or a Schedule R for 1040 filers. Schedule R (Form 1040) and Schedule 3 (Form 1040A) are almost identical. The instructions for completing Schedule 3 can be used to complete Schedule R.

Example 1

Carlos (000-00-9850) and Lucinda Fernandez are married and file a joint return. Their respective ages are 66 and 68. They received nontaxable social security benefits of \$4,500 in 2002. They had adjusted gross income (line 35, Form 1040) of \$13,000. Parts I and III of the Schedule R will be completed and the schedule attached to their Form 1040 for 2002. (Part II need not be completed since both are age 65 or older.) See Exhibits 3 and 4.

For additional information on the credit for the elderly, refer to the instructions for the schedules or Publication 524, *Credit for* the Elderly or the Disabled.

Figure A. Are you a Qualified Individual?



¹ If you were a nonresident alien at any time during the tax year and were married to a U.S. citizen or resident at the end of the tax year, see U.S. citizen or resident under *Qualified individual*. If you and your spouse both choose to be treated as U.S. residents, answer yes to this question.

Exhibit 2 Income Limits

Figure B. Income Limits

Even if you qual	Even if you qualify (see Figure A), you CANNOT take the credit if:								
Your filing status is	AND your adjusted gross income (AGI)* is equal to or more than	OR your nontaxable social security or other nontaxable pension(s) is equal to or more than							
Single, Head of household, or Qualifying widow(er) with dependent child	\$17,500	\$5,000							
Married filing a joint return and both spouses qualify in <i>Figure A</i>	\$25,000	\$7,500							
Married filing a joint return and only one spouse qualifies in <i>Figure A</i>	\$20,000	\$5,000							
Married filing a separate return and you did not live with your spouse at any time during the year	\$12,500	\$3,750							

^{*}AGI is the amount on Form 1040A, line 20, or Form 1040, line 34.

Lesson 15 15-3
PENSION EARNER

² Mandatory retirement age is the age set by your employer at which you would have been required to retire, had you not become disabled.

Schedule R (Form 1040)

Credit for the Elderly or the Disabled

OMB No. 1545-0074 Attachment

Department of the Treasury Internal Revenue Service (99) Sequence No. 16 ▶ Attach to Form 1040. ▶ See Instructions for Schedule R (Form 1040). Name(s) shown on Form 1040 Your social security number Carlos and Lucinda Fernandez 000 00 9850 You may be able to take this credit and reduce your tax if by the end of 2002: • You were age 65 or older or • You were under age 65, you retired on permanent and total disability, and you received taxable disability income. But you must also meet other tests. See page R-1. In most cases, the IRS can figure the credit for you. See page R-1. Check the Box for Your Filing Status and Age Part I If your filing status is: And by the end of 2002: Check only one box: Single, 1 You were 65 or older Head of household, or Qualifying widow(er) You were under 65 and you retired on permanent and total disability 2 with dependent child X Both spouses were 65 or older. Both spouses were under 65, but only one spouse retired on Married filing Both spouses were under 65, and both retired on permanent and total jointly One spouse was 65 or older, and the other spouse was under 65 and One spouse was 65 or older, and the other spouse was under 65 and You were 65 or older and you lived apart from your spouse for all of Married filing separately You were under 65, you retired on permanent and total disability, and you lived apart from your spouse for all of 2002 9 Did you check Yes -Skip Part II and complete Part III on back. box 1, 3, 7, or 8? No -Complete Parts II and III. Part II Statement of Permanent and Total Disability (Complete only if you checked box 2, 4, 5, 6, or 9 above.) If: 1 You filed a physician's statement for this disability for 1983 or an earlier year, or you filed or got a statement for tax years after 1983 and your physician signed line B on the statement, and 2 Due to your continued disabled condition, you were unable to engage in any substantial gainful activity If you checked this box, you do not have to get another statement for 2002. If you did not check this box, have your physician complete the statement on page R-4. You must keep the statement for your records. For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11359K Schedule R (Form 1040) 2002

Sche	dule R (Form 1040) 2002		P	age 2
Pa	rt III Figure Your Credit			
10	If you checked (in Part I): Enter:	10 7	,500	00
11	If you checked (in Part I): Box 6, add \$5,000 to the taxable disability income of the spouse who was under age 65. Enter the total. Box 2, 4, or 9, enter your taxable disability income. Box 5, add your taxable disability income to your spouse's taxable disability income. Enter the total.	11		
	For more details on what to include on line 11, see page R-3.			
12	If you completed line 11, enter the smaller of line 10 or line 11; all others, enter the amount from line 10	12 7	,500	00
b	Enter the following pensions, annuities, or disability income that you (and your spouse if filing a joint return) received in 2002. Nontaxable part of social security benefits and Nontaxable part of railroad retirement benefits treated as social security. See page R-3. Nontaxable veterans' pensions and Any other pension, annuity, or disability benefit that is excluded from income under any other provision of law. See page R-3. Add lines 13a and 13b. (Even though these income items are not taxable, they must be included here to figure your credit.) If you did not receive any of the types of nontaxable income listed on line 13a or 13b, enter -0- on line 13c			
18	Add lines 13c and 17	18 6	,000	00
19	Subtract line 18 from line 12. If zero or less, stop; you cannot take the credit. Otherwise, go to line 20	19 1	,500	00
20 21 22	Multiply line 19 by 15% (.15)	20	225	00
23	Subtract line 22 from line 21	23	0	00
24	Credit for the elderly or the disabled. Enter the smaller of line 20 or line 23 here and on Form 1040, line 47	24 Schedule R (Fo	225 rm 1040)	00
	❸	ochedule n (FO	1040)	2002

	TUOTES
S	TUDENT NOTES

Introduction

In this section, you will complete tax returns for several common pension earner scenarios often encountered at volunteer assistance sites. This will be valuable practice as you prepare to help taxpayers. Although answers to each of the problems are shown at the end of this section, you should try to complete the blank forms for each problem before referring to its answers.

After completing this section, you will be able to:

accurately complete a basic tax return with some advanced topics.

Problem 1

Kirk J. Evergreen, SSN 000-00-2345, lives at 2610 Yellowstone Street, Missoula, MT 59810. He is 68 and retired. He files a joint return with his wife, Mary, age 55, whose social security number (SSN) is 000-00-5678. They do not wish to contribute to the Presidential Election Campaign Fund. They would like any overpayment mailed to their home.

They have \$36 of tax-exempt interest; they have a Form 1099-INT indicating \$287 of interest. Kirk indicates that he received a Form SSA-1099 showing that he was paid \$7,200 in social security benefits. He also received a small taxable pension of \$4,500. He provides documentation substantiating these amounts.

Mary has a part-time job as a clerk, and her Form W-2 indicates that she earned \$12,637 with \$619 of Federal tax withheld. Mary plans to make a \$900 payment to her traditional IRA account; she will make her contribution by the due date of the return.

Kirk and Mary visit TCE Site #101, on 3/16/2003.

Complete this fo	orm.									Form 1040A,	page
Form	Depai	rtment of the Treasur	y—Internal Reven	ue Service							
1040A	U.S	6. Individual	Income Ta	ax Returr	1 (99)	200	2 IRS Use	Only—Do	not write	or staple in this	space.
Label	Your	first name and initial		Last name				``}	0	MB No. 1545-008	5
(See page 19.)									Your so	cial security num	ber
A B								2		<u> </u>	
l E	If a j	oint return, spouse's firs	t name and initial	Last name					Spouse's	s social security nu	umber
Use the LIRS label.											
Otherwise.	Hom	e address (number and	street). If you have a	P.O. box, see page	e 20.		Apt. no).	▲ In	nportant	1 🛦
please print or type.	City	town or post office, sta	te and ZID code If y	ou have a foreign	address see n	age 20		\mathbf{H}		must enter yo	
or type.	Oity,	town or post office, sta	te, and Zii code. ii y	ou nave a loreign i	address, see p	age 20.				SSN(s) above.	Jui
Presidential Election Campaign		Note. Checking "Y	oo" will not obor	ago your toy	r raduos va	nur rofund			You	Spous	se
(See page 20.)		Do you, or your sp				to this fu	und?	>	Yes	□No □Yes	
Filing	1	Single								person). (See pag	
status	2		ointly (even if on				t the qualitying penter this child's			ut not your depe	naent,
Observation	3 ∟		eparately. Enter	spouse's 551	v above an	<u> </u>				dependent cl	hild
Check only one box.		Idii Hamo nore.					year spouse		VVICIT). (See page	
Exemptions	6a	☐ Yourself.	If your pare)	No. of boxes checked on	
	b	☐ Spouse	dependent (on his or he	er tax reti	ırn, do	not check b	оох ба.	}	6a and 6b	
	c					(3) [Dependent's	(4) √if qua	alifying	No. of children on 6c who:	
	·	Dopondonto			lent's social		tionship to	child for	child	lived with	
If more than six		(1) First name	Last name	security	number		you	tax credi page 2		you	
dependents,										 did not live with you due 	
see page 22.				1	!					to divorce or separation	
										(see page 24)	
										Dependents on 6c not	
	-			1	- !					entered above	
					<u> </u>			Ш		Add numbers	
	d	Total number	of exemptio	ns claimed						on lines above	
Income		Total Hallison	от охоттрые	no olamioa.	<u>'</u>						
	7	Wages, salari	ies, tips, etc.	Attach For	m(s) W-2				7		
Attach Form(s) W-2											
here. Also		Taxable inter							8a		<u> </u>
attach		Tax-exempt int				8b			_		
Form(s) 1099-R if tax	9	Ordinary divid	enas. Attacn	Schedule I	it require	a.			9		
was withheld.	10	Capital gain	distributions	(see nage 2	25)				10		
If you did not		IRA		usso page z		11h 7	Taxable amo	unt	10		
get a W-2, see		distributions.	11a				see page 25		11b		
page 25.	12a	Pensions and					Taxable amo	•			
Enclose, but do not attach, any		annuities.	12a				see page 26		12b		
payment.							_	_			
	13	Unemployme		ation and Al	aska Per				13		-
	14a	Social securit	•				Taxable amo		4.41		
		benefits.	14a			(:	see page 28	9).	14b		
	15	Add lines 7 th	rough 14b (fa	ır right colur	nn). This	is your	total income	e. >	15		
Adjusted	16	Educator expe				16					
gross	17	IRA deduction				17					
income	18	Student loan				18					
	19 20	Tuition and fe		<u> </u>		19	monto		20		ı
	20	Add lines 16	unougn 19.	mese are y	our total	aujusi	unents.		20		+
	21	Subtract line 2	20 from line 1	5. This is yo	our adjus t	ted gro	ss income.	>	21		
For Disclosure P								0 112074		Form 1040A	(2002)

CP-2 Comprehensive Problems

PENSION EARNER

Complete this form. Form 1040A, page 2 Form 1040A (2002) Page 2 Enter the amount from line 21 (adjusted gross income). 22 Tax, credits. ☐ You were 65 or older ☐ Blind I Enter number of and ☐ Blind ∫ ☐ Spouse was 65 or older boxes checked ▶ payments b If you are married filing separately and your spouse itemizes Standard deductions, see page 32 and check here Deduction Enter your standard deduction (see left margin). 24 People who Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-. 25 checked any Multiply \$3,000 by the total number of exemptions claimed on line 6d. 26 box on line 23a or 23b **or** Subtract line 26 from line 25. If line 26 is more than line 25, enter -0who can be 27 This is your taxable income. claimed as a dependent, 28 28 Tax, including any alternative minimum tax (see page 33) see page 33. 29 Credit for child and dependent care expenses. All others: Attach Schedule 2. Single, \$4,700 Credit for the elderly or the disabled. Attach Head of Schedule 3. 30 household, \$6,900 Education credits. Attach Form 8863 31 Married filing Retirement savings contributions credit. Attach jointly or Form 8880. 32 Qualifying widow(er), 33 Child tax credit (see page 36). 33 \$7,850 34 Adoption credit. Attach Form 8839 34 Married 35 Add lines 29 through 34. These are your total credits. 35 filina separately, 36 Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-. 36 \$3,925 37 Advance earned income credit payments from Form(s) W-2. 37 38 Add lines 36 and 37. This is your total tax. ▶ 38 39 Federal income tax withheld from Forms W-2 and 1099. 39 40 2002 estimated tax payments and amount If you have applied from 2001 return. 40 a qualifying 41 Earned income credit (EIC). 41 child, attach 42 Additional child tax credit. Attach Form 8812. 42 Schedule EIC. 43 Add lines 39 through 42. These are your total payments. ▶ 43 44 If line 43 is more than line 38, subtract line 38 from line 43. Refund 44 This is the amount you overpaid. Direct ▶ 45a Amount of line 44 you want refunded to you. deposit? Routing See page 47 ▶ **c** Type: ☐ Checking ☐ Savings number and fill in 45b, 45c, Account **▶** d and 45d. number 46 Amount of line 44 you want applied to your 2003 estimated tax. 47 Amount you owe. Subtract line 43 from line 38. For details on how Amount ▶ 47 to pay, see page 48. vou owe Estimated tax penalty (see page 48) Do you want to allow another person to discuss this return with the IRS (see page 49)?

Yes. Complete the following.

No Third party Designee's Personal identification designee nο number (PIN) Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my Sign knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration here of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge. Your signature Your occupation Daytime phone number Date Joint return? See page 20. Кеер а сору Spouse's signature. If a joint return, both must sign. Date Spouse's occupation for your records. Date Preparer's SSN or PTIN Preparer's signature **Paid** Check if self-employed preparer's Firm's name (or EIN yours if self-employed), use only Phone no address, and ZIP code

➂

Comprehensive **Problems** PENSION EARNER

Form 1040A (2002)

Complete this form.

Social Security Benefits Worksheet

	fore you begin: \(\text{Complete Form 1040A, lines 16 and 17, if it applies to you.} \)		6 2006
	√ If you are married filing separately and you lived apart from your spouse for enter 'D' to the right of the word 'benefits' on line 14a.		
	√ Be sure you have read the Exception on page 30 to see if you can use this we instead of a publication to find out if any of your benefits are taxable.	orksh	eet
۱.	Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099 1.		
2.	Is the amount on line 1 more than zero?		
	No. STOP None of your social security benefits are taxable.		
	Yes. Enter one-half of line 1	. 2.	
3.	Add the amounts on Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099		
4.	Enter the amount, if any, from Form 1040A, line 8b	. 4.	
5.	Add lines 2, 3, and 4	. 5.	
6.	Add the amounts on Form 1040A, lines 16 and 17	. 6.	
7.	Is the amount on line 6 less than the amount on line 5?		
	No. Stop None of your social security benefits are taxable.		
	Yes. Subtract line 6 from line 5	. 7.	
8.	Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apar from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you live with your spouse at any time in 2002	d	
	Is the amount on line 8 less than the amount on line 7? No. Stop None of your social security benefits are taxable. You do not have to enter any amount on line 14 or 14b of Form 1040A. But if you are married filing separately and you lived apart from you spouse for all of 2002, enter -0- on line 14b. Be sure you entered 'D' to the right of the word 'benefits' on line 14a.	r	
	Yes. Subtract line 8 from line 7	. 9.	
0.	Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apar from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you live with your spouse at any time in 2002	d	
	Subtract line 10 from line 9. If zero or less, enter -0		
1.	Enter the smaller of line 9 or line 10	. 12.	
	Enter one-half of line 12	. 13.	
2.	Enter the fidir of fine 12.		
 3. 	Enter the smaller of line 2 or line 13	. 14.	
2. 3. 4.			
2. 3. 4. 5.	Enter the smaller of line 2 or line 13	. 15.	
2. 3. 4. 5.	Enter the smaller of line 2 or line 13	. 15. . 16.	
2. 3. 4. 5. 6. 7.	Enter the smaller of line 2 or line 13	. 15. . 16. . 17.	
 3. 	Enter the smaller of line 2 or line 13	. 15. . 16. . 17.	

Problem 2

Paul and Mary Birch are married and file a joint return.

They live at 123 Green Street, Claremont, CA 91711.

Paul's SSN is 000-00-4321 and Mary's is 000-00-2221. They both want to contribute to the Presidential Election Campaign Fund. They have no dependents.

Paul's wages for 2002 were \$28,542. He works as a computer technician. Mary was self-employed, earning \$7,800 teaching craft classes. Her only expense was \$450 for materials and supplies. Her principal business code is 812990. Paul had \$4,575 of federal taxes withheld from his wages. Mary paid estimated taxes of \$1,625 in 2002.

Paul and Mary received \$478 interest income from their savings account with Main Street Bank. Dividend income was \$242 ordinary dividends from ABC Corporation, and \$317 ordinary dividends, plus \$179 capital gain distributions from XYZ Corporation. On July 9, 2002, Mary sold 200 shares of stock in ABC Corporation. The Form 1099-B reports a net sales price of \$3,300. She had purchased this stock on November 21, 1998, at a cost of \$18.45 per share plus a broker's commission of \$87. In addition, on October 23, 2002, she sold 500 shares of XYZ Markets, Inc., which she purchased on February 18, 2000, at a cost of \$35.00 per share, including broker's commissions. The Form 1099-B reports a net sales price of \$25,000. They have no foreign accounts or trusts.

Paul and Mary are taking a standard deduction. Neither is 65 or more, or blind. You are helping them at TCE Site #33 on Feb. 14, 2003. They want any refund mailed to their home.

Complete this form. Form 1040, page 1

	For the year Jan. 1–Dec. 31, 2002, or other tax year beginning , 2002, ending , 20	OMB No. 1545-0074
Label	Your first name and initial Last name	Your social security number
See L nstructions B	If a joint return, spouse's first name and initial Last name	Spouse's social security numbe
on page 19.)	if a joint return, spouse's first fiame and finitial	Spouse's social security number
Use the IRS HOTHER BEING	Home address (number and street). If you have a P.O. box, see page 19.	▲ Important! ▲
please print or type.	City, town or post office, state, and ZIP code. If you have a foreign address, see page 19.	You must enter your SSN(s) above.
Presidential 🔾		You Spouse
Election Campaign (See page 19.)	Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if filing a joint return, want \$3 to go to this fund?	
(coopings to)		
Filing Status	2 Married filing jointly (even if only one had income) the qualifying person is a cl	, , , , , , ,
Check only	3 ☐ Married filing separately. Enter spouse's SSN above this child's name here. ▶	
one box.	and full name here. ▶	
	spouse died ►).	\ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \
Exemptions	6a Vourself. If your parent (or someone else) can claim you as a dependent on his or her return, do not check box 6a	checked on
	b Spouse	
	c Dependent's (2) Dependent's (3) Dependent's stationship to shift for shift	ying on 6c who:
	(1) First name Last name social security number relationship to you credit (see pag	
		you due to divorce
If more than five dependents,		(see page 20)
see page 20.		Dependents on 6c
		on lines
	d Total number of exemptions claimed	
Income	7 Wages, salaries, tips, etc. Attach Form(s) W-2	
	8a Taxable interest. Attach Schedule B if required	
Attach Forms W-2 and		
W-2G here.	 Ordinary dividends. Attach Schedule B if required Taxable refunds, credits, or offsets of state and local income taxes (see page 22) 	
Also attach	11 Alimony received	
Form(s) 1099-R if tax was	12 Business income or (loss). Attach Schedule C or C-EZ	12
withheld.	13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ □	13
	14 Other gains or (losses). Attach Form 4797	14
If you did not	15a IRA distributions 15a b Taxable amount (see page 23)	15b
get a W-2,	16a Pensions and annuities 16a b Taxable amount (see page 23)	16b
see page 21.	17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17
Enclose, but do	18 Farm income or (loss). Attach Schedule F	18
not attach, any payment. Also,	19 Unemployment compensation	
please use	20a Social security benefits . 20a b Taxable amount (see page 25)	
Form 1040-V.	 Other income. List type and amount (see page 27) Add the amounts in the far right column for lines 7 through 21. This is your total income 	
	00	with dependent child (year). (See page 19.) her tax qualifying child tax e page 20) Dependents on 6c ont entered above Add numbers on lines above > 7 8a 9 10 11 12 13 14 15b 16b 17 18 19 20b 21
Adjusted	23 Educator expenses (see page xx)	
Gross	25 Student loan interest deduction (see page 28)	
Income	26 Tuition and fees deduction (see page XX)	
	27 Archer MSA deduction. Attach Form 8853	
	28 Moving expenses. Attach Form 3903	
	29 One-half of self-employment tax. Attach Schedule SE . 29	
	30 Self-employed health insurance deduction (see page 30)	
	31 Self-employed SEP, SIMPLE, and qualified plans 31	
	32 Penalty on early withdrawal of savings	
	33a Alimony paid b Recipient's SSN ▶ 33a	
	34 Add lines 23 through 33a	34

	forn				
orm 1040 (2002)					Page 2
Tax and Credits	36 37a	Amount from line 35 (adjusted gross income)	ise was 65 or olde	er, 🗌 Blind.	36
Standard Deduction	b	Add the number of boxes checked above and enter the If you are married filing separately and your spouse item			
Feople who	38	you were a dual-status alien, see page 31 and check he Itemized deductions (from Schedule A) or your standa			38
checked any box on line	39	Subtract line 38 from line 36			39
37a or 37b or who can be	40	If line 36 is \$103,000 or less, multiply \$3,000 by the tota			
claimed as a dependent,		line 6d. If line 36 is over \$103,000, see the worksheet o	n page 32		40
see page 31.	41	Taxable income. Subtract line 40 from line 39. If line 40			41
All others: Single,	42	Tax (see page 33). Check if any tax is from a Form(s) 88		n 4972	42 43
\$4,700	43	Alternative minimum tax (see page 34). Attach Form 6.			44
Head of nousehold,	44 45	Add lines 42 and 43	45		
6,900	46	Credit for child and dependent care expenses. Attach Form			
Married filing ointly or	47	Credit for the elderly or the disabled. Attach Schedule F			
Qualifying	48	Education credits. Attach Form 8863	48		
widow(er), \$7,850	49	Retirement savings contributions credit. Attach Form 88			
Married	50	Child tax credit (see page XX)	50		
filing separately,	51	Adoption credit. Attach Form 8839	51		
\$3,925	52	Credits from: a Form 8396 b Form 8	<i>\/////</i>		
	53	Other credits. Check applicable box(es): a Form 3 b Form 8801 c Specify	800 //////		
	54			I	54
	55	Subtract line 54 from line 44. If line 54 is more than line			55
746 a.u	56	Self-employment tax. Attach Schedule SE			56
Other Taxes	57	Social security and Medicare tax on tip income not reported			57
ancs	58	Tax on qualified plans, including IRAs, and other tax-favored ac	counts. Attach Form	5329 if required .	58
	59	Advance earned income credit payments from Form(s) \	V-2		59
	60				60
) a	61		00	<u> ▶</u>	61
ayments	62 63	Federal income tax withheld from Forms W-2 and 1099 2002 estimated tax payments and amount applied from 2001 return			
f you have a	64	Earned income credit (EIC)			
qualifying	65	Excess social security and tier 1 RRTA tax withheld (see page			
child, attach Schedule EIC.	66	Additional child tax credit. Attach Form 8812	´		
	67	Amount paid with request for extension to file (see pag	e 51) 67		
	68	Other payments from: a Form 2439 b Form			
	69	Add lines 62 through 68. These are your total payment	s	<u> ▶</u>	69
Refund	70	If line 69 is more than line 61, subtract line 61 from line 6	9. This is the amou	unt you overpaid	70
irect deposit? ee page 51	71a	Amount of line 70 you want refunded to you		•	71a
nd fill in 71b,	b d	Routing number Account number	► c Type: ☐ Check	king Savings	
1c, and 71d.	72	Amount of line 70 you want applied to your 2003 estimated ta	x ▶ 72		
Amount ou Owe	73 74	Amount you owe. Subtract line 69 from line 61. For det Estimated tax penalty (see page 52)	ails on how to pay	, see page 52 ►	73
hird Party		you want to allow another person to discuss this return w		ge 53)?	Complete the following. N
Designee		ignee's Phone	, ,	Personal identif	ication
Sign	nar Und	er penalties of perjury, I declare that I have examined this return and	accompanying schedu	ules and statements, a	nd to the best of my knowledge and
Here	beli	of, they are true, correct, and complete. Declaration of preparer (other	than taxpayer) is based	d on all information of	which preparer has any knowledge.
oint return?	You	r signature Date	Your occupation		Daytime phone number
See page 19.					()
Keep a copy or your	Spo	use's signature. If a joint return, both must sign. Date	Spouse's occupa	ation	
ecords.		parer's	Date	Check if	Preparer's SSN or PTIN
	sigi	parer's ature	Date	Check if self-employed EIN	Preparer's SSN or PTIN

Comprehensive Problems CP-7

PENSION EARNER

Complete this form. 2002 Schedule B

Name(s) shown on F	Form 1040. Do not enter name and social security number if shown on other side.	Your social security number
	Schedule B—Interest and Ordinary Dividends	Attachment Sequence No. 0
Part I Interest See page B-1 and the nstructions for Form 1040, ine 8a.)	1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶	Amount 1
Note. If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, ist the firm's name as the payer and enter the total interest shown on that form.	2 Add the amounts on line 1	2 3 4
Part II Ordinary Dividends See page B-1 and the nstructions for Form 1040, ine 9.)	5 List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13 ▶	Amount
eceived a Form 099-DIV or substitute statement from a brokerage firm, st the firm's name as the sayer and enter the ordinary lividends shown		5
eceived a Form 099-DIV or ubstitute tatement from brokerage firm, st the firm's ame as the vayer and enter ne ordinary lividends shown	6 Add the amounts on line 5. Enter the total here and on Form 1040, line 9 . ▶ Note. If line 6 is over \$400, you must complete Part III.	6
Note. If you received a Form 1099-DIV or substitute statement from a brokerage firm, ist the firm's name as the payer and enter the ordinary dividends shown on that form. Part III Foreign Accounts and Trusts See	6 Add the amounts on line 5. Enter the total here and on Form 1040, line 9 . ▶ Note. If line 6 is over \$400, you must complete Part III. You must complete this part if you (a) had over \$400 of taxable interest or ordinary divider foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a 7a At any time during 2002, did you have an interest in or a signature or other authority account in a foreign country, such as a bank account, securities account, or	nds; (b) had a a foreign trust. Over a financial other financial 22.1



Complete this form. Schedule C-EZ

	HEDULE C-EZ	Net Profit From Business			<u> </u>	OMB No.	1545	-0074	
(For	m 1040)	(Sole Proprietorship)				20	0	2	
	ment of the Treasury Il Revenue Service (99)	 Partnerships, joint ventures, etc., must file Form 1065 or 1065-B. Attach to Form 1040 or 1041. ▶ See instructions on back. 			A	ttachme equence	nt No.	09/	Α
	of proprietor	7 7	Soc	ial se		number			<u> </u>
Par	t I General I	nformation			:	<u>:</u>			
Sche Inste Sche	May Use edule C-EZ ead of edule C	 Had business expenses of \$2,500 or less. Use the cash method of accounting. Did not have an inventory at any time during the year. Did not have a net loss from your business. Had only one business as a sole proprietor. Had business or Are not represent this busin for Scheet C-3 to fire. Do not do business. Do not have a net loss from your business as a sole proprietor. 	equirition and the second of t	ed to and Air See to C, line if you to expend of you or in the contract of your or in the contract expends of your or you or in the contract expends and the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expends are in the contract expension.	file Formortization in the instance of the ins	eation, fatruction page st file. for ne.	62, for ns e		
A	Principal business o	r profession, including product or service	В	Enter	code 1	rom pa	ges	C-7 8	8
С	Business name. If n	o separate business name, leave blank.	D	Emplo	yer ID	numbe	r (El	N), i1	any
E	Business address (ir	ncluding suite or room no.). Address not required if same as on Form 1040, page 1.		<u> </u>					
	0:1	(7)							
	City, town or post o	ffice, state, and ZIP code							
Par	t II Figure Yo	ur Net Profit							
1	employee" box or	aution. If this income was reported to you on Form W-2 and the "Statutory that form was checked, see Statutory Employees in the instructions for , on page C-2 and check here		1					_
2	Total expenses.	f more than \$2,500, you must use Schedule C (see instructions)		2					
3	Form 1040, line 1	act line 2 from line 1. If less than zero, you must use Schedule C. Enter c 2, and also on Schedule SE, line 2 . (Statutory employees do not report the ule SE, line 2. Estates and trusts, enter on Form 1041, line 3.)		3					
Par		on on Your Vehicle. Complete this part only if you are claiming car of	or tru		xper	nses c	n li	ne 2	2.
4	When did you pla	ce your vehicle in service for business purposes? (month, day, year) ▶	/		/				
5		er of miles you drove your vehicle during 2002, enter the number of miles					e fo	or:	
а	Business	b Commuting c Other							
6	Do you (or your sp	pouse) have another vehicle available for personal use?			. [☐ Yes	6		No
7	Was your vehicle	available for personal use during off-duty hours?			. [Yes	6		No
8a	Do you have evide	ence to support your deduction?			. [☐ Yes	3		No
b	If "Yes," is the evi	dence written?	<u>.</u>	<u>. </u>	[Yes	<u> </u>	П	No_
		n Act Notice, see Form 1040 instructions. Cat. No. 14374D				Z (Form	10	40) 2	2002

Complete this form. Schedule SE

SCHEDULE SE	 I			OMB No. 1545-0074
(Form 1040)	Self-	Employme	nt Tax	2002
Department of the Treasury Internal Revenue Service (99)	► Attach to Form 1040. ►	See Instructions	for Schedule SE (Form 1040).	Attachment Sequence No. 17
Name of person with se	elf-employment income (as shown on F	Form 1040)	Social security number of person with self-employment income ▶	
		er than church e	employee income (line 4 of Short	Schedule SE or line 4c o
You had church en religious order is no lote. Even if you had	nployee income of \$108.28 or mor ot church employee income. See p d a loss or a small amount of incom	page SE-1. ne from self-emp	loyment, it may be to your benef	
Exception. If your on oractitioner and you f	nethod" in Part II of Long Schedule ly self-employment income was fro iled Form 4361 and received IRS ap 4361" on Form 1040, line 56.	m earnings as a	minister, member of a religious of	
May I Use Sho	rt Schedule SE or Must I	Use Long	Schedule SE?	
	Did You F	teceive Wages or T	ips in 2002?	
Science practitioner who	hber of a religious order, or Christian received IRS approval not to be taxed ources, but you owe self-employment	→ or	as the total of your wages and tips subject railroad retirement tax plus your ne ff-employment more than \$84,900?	
	No			
Are you using one of the earnings (see page SE-3	e optional methods to figure your net Yes	→	No	
	No		d you receive tips subject to social security at you did not report to your employer?	y or Medicare tax Yes
Did you receive church W-2 of \$108.28 or more?	employee income reported on Form Yes	→		
	No			
You May Use	Short Schedule SE Below	<u> </u>	You Must Use Long Schedule	SE on the Back
	Schedule SE. Caution. Read abo			
1 Net farm profit 1065), line 15a	or (loss) from Schedule F, line 36,		' '	1
line 15a (other t	ss) from Schedule C, line 31; Schedhan farming); and Schedule K-1 (Fors, see page SE-1 for amounts to tour or the control of t	orm 1065-B), bo report on this li	ox 9. Ministers and members ne. See page SE-2 for other	2
	and 2			3
do not file this	rom self-employment. Multiply lin schedule; you do not owe self-emp int tax. If the amount on line 4 is:			4
• •	ss, multiply line 4 by 15.3% (.153).	Enter the result	here and on	5
 More than \$8 	4,900, multiply line 4 by 2.9% (.02) the total here and on Form 1040, l i		10,527.60 to the	
	one-half of self-employment tax. the result here and on Form 1040,			

Schedule SE (Form 1040) 2002

Cat. No. 11358Z

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Complete this form. 2002 Schedule D, page 1

SCHEDULE D (Form 1040)

Department of the Treasury

Capital Gains and Losses

► Attach to Form 1040.

► See Instructions for Schedule D (Form 1040).

▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.

OMB No. 1545-0074

Attachment Sequence No. 12

Name(s) shown on Form 1040 Your social security number Short-Term Capital Gains and Losses—Assets Held One Year or Less (b) Date acquired (d) Sales price (see page D-5 of (e) Cost or other basis (a) Description of property (Example: 100 sh. XYZ Co.) (c) Date sold (f) Gain or (loss) (see page D-5 of the instructions) Subtract (e) from (d) (Mo., day, yr.) (Mo., day, yr.) the instructions) Enter your short-term totals, if any, from Schedule D-1, line 2. Total short-term sales price amounts. Add lines 1 and 2 in column (d) Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts 5 from Schedule(s) K-1 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 6 7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f). Long-Term Capital Gains and Losses—Assets Held More Than One Year Part II (d) Sales price (see page D-5 of (b) Date (e) Cost or other basis (g) 28% rate gain or (a) Description of property (c) Date sold (f) Gain or (loss) acquired (Mo., day, yr.) (see page D-5 of the (loss) * (see instr. below) (Example: 100 sh. XYZ Co.) (Mo., day, yr.) Subtract (e) from (d) instructions) the instructions) 8 Enter your long-term totals, if any, from Schedule D-1, line 9 9 Total long-term sales price amounts. 10 Add lines 8 and 9 in column (d) Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and 11 long-term gain or (loss) from Forms 4684, 6781, and 8824 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts 12 13 Capital gain distributions. See page D-1 of the instructions Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if 14 any, from line 13 of your 2001 Capital Loss Carryover Worksheet 15 Combine lines 8 through 14 in column (g) Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) 16 Next: Go to Part III on the back.

*28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of

Cat. No. 11338H

the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Comprehensive **CP-1**

Schedule D (Form 1040) 2002

2002 Schedule D. page 2

	rt III Taxable Gain or Deductible Loss	Page 2
,	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41.	17
	 Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040. 	
	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18 (
	 Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. 	
a	rt IV Tax Computation Using Maximum Capital Gains Rates	
)	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	
	Enter your taxable income from Form 1040, line 41	
	Enter the smaller of line 16 or line 17 of Schedule D	
	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-	
	Subtract line 22 from line 21. If zero or less, enter -0	
	Subtract line 23 from line 20. If zero or less, enter -0	25
	Enter the smaller of:	
	 The amount on line 20 or \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; 26 	
	\$27,950 if single; \$37,450 if head of household; or	
	\$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines	
	27 through 33 and go to line 34.	
	Enter the amount from line 24	
	Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 29	
	Enter the smaller of line 28 or line 29	
	Multiply line 30 by 8% (.08)	31
	Multiply line 32 by 10% (.10)	33
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.	
	Enter the smaller of line 20 or line 23	
	Enter the amount from line 28 (if line 28 is blank, enter -0-)	
	Multiply line 36 by 20% (.20)	37
	Add lines 25, 31, 33, and 37	38
	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	39
_	and on Form 1040, line 42	40

Problem 1 Form 1040A, page 1

		Department of the Treasury—Internal Ro	nuanua Camilaa							
Form		,		_	200					
1040A	_	U.S. Individual Income		(99)	200	IRS Us	e Only—D		or staple in this s	_
Label		Your first name and initial	Last name				`}_		MB No. 1545-0085	
(See page 19.)	L							Your so	cial security numb	ber
(*** ****)	A B	Kirk J.	Evergree	n					00 2345	
	Е	If a joint return, spouse's first name and initi	al Last name					Spouse's	s social security nu	mber
Use the	L	Mary	Evergree	n				000	00 5678	
IRS label.	H	Home address (number and street). If you ha	ave a P.O. box, see page	e 20.		Apt. r	10.	A 1-		_
Otherwise, please print	R	2610 Yellowstone St.						▲ In	nportant!	
or type.	Е	City, town or post office, state, and ZIP cod	e. If you have a foreign a	address, see pag	ge 20.				must enter yo	our
(Missoula, MT 59810							SSN(s) above.	
Presidential									•	
Election Campai	ign	Note. Checking "Yes" will not	change your tax o	r reduce you	ır refur	nd.		You	•	
(See page 20.)		Do you, or your spouse if filing	a joint return, war	nt \$3 to go t	o this	fund?		Yes	X No ☐ Yes	X No
Filing		1 Single			4	Head of househ	old (with o	gualifying	person). (See pag	ie 21.)
status		2 X Married filing jointly (even	f only one had inc						ut not your deper	
Status		3 Married filing separately. E				enter this child's			, ,	,
Check only		full name here. ▶			5 🗋	Qualifying w	/idow(e	r) with	dependent ch	nild
one box.						(year spous). (See page	
Exemption	16	6a X Yourself. If your p	arent (or some	one else)	can c	laim vou as	a	1	No. of boxes	
_xcmption			nt on his or he					. }	checked on 6a and 6b	2
		b 🗵 Spouse						<u>J</u>	No. of children	
		c Dependents:	(0) D		(3)	Dependent's	(4) √if q		on 6c who:	
			security	lent's social number		ationship to	child fo		lived with you	
If more than six		(1) First name Last nam	e Scounty	Hamber		you	page		did not live	
dependents,				:]	with you due	
see page 22.			1	1]	to divorce or separation	
				-]	(see page 24)	
			1	1]	Dependents	
				-]	on 6c not entered above	
			1	1]	cincica above	
				•	•				Add numbers on lines	
		d Total number of exemp	otions claimed.						above	2
Income										
Attach		7 Wages, salaries, tips, e	etc. Attach For	m(s) W-2.				7	12,637	00
Form(s) W-2										
here. Also		8a Taxable interest. Attac	h Schedule 1 i	f required				8a	287	00
attach		b Tax-exempt interest. Do i	not include on lir	ne 8a.	8b		36 00	_		
Form(s)		9 Ordinary dividends. Atta	ch Schedule 1	if required				9		
1099-R if tax was withheld.										
was withheid.	•	10 Capital gain distributio	ns (see page 2	25).				10		
If you did not		11a IRA				Taxable amo				
get a W-2, see page 25.		distributions. 11a				(see page 2		11b		
. •		12a Pensions and				Taxable amo				
Enclose, but do not attach, any		annuities. 12a				(see page 2	6).	12b	4,500	00
payment.										
		13 Unemployment compe	nsation and Al	aska Pern	naner	nt Fund divid	lends.	13		
		14a Social security			14b	Taxable amo	ount			
		benefits. 14a				(see page 2	8).	14b		
		15 Add lines 7 through 14b	<u> </u>	nn). This is		total incom	e. ▶	15	17,424	00
Adjusted		16 Educator expenses (see	<u> </u>		16			_		
gross		17 IRA deduction (see pag			17	90	00 00	_		
income		18 Student loan interest de			18			_		
		19 Tuition and fees deduct			19			_		
		20 Add lines 16 through 1	9. These are y	our total	adjus	tments.		20	900	00
					_	_				
		21 Subtract line 20 from lin	ie 15. This is yo	our adjust e	ed gro	oss income.	<u> </u>	21	16,524	00
For Disclosure	e, P	rivacy Act, and Paperwork Red	duction Act Not	ice, see pa	age 5	3. Cat. 1	No. 11327	4	Form 1040A ((2002)

Form 1040A, page 2

Form 1040A	(2002				P	age 2
Tax,	22	Enter the amount from line 21 (adjusted gross income).		22 1	6,524	00
credits,				1		
and	23a	Check	1			
payments	b	If you are married filing separately and your spouse itemizes	a L	!		
Standard		deductions, see page 32 and check here	Bb □		ı	
Deduction for—	24	Enter your standard deduction (see left margin).		24	8,750	00
People who	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-		25	7,774	00
checked any box on line	26	Multiply \$3,000 by the total number of exemptions claimed on line 60		26	6,000	00
23a or 23b or who can be	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-			1 12121	00
claimed as a dependent,		This is your taxable income .		27	1,774	00
see page 33.	28 29	Tax, including any alternative minimum tax (see page 33). Credit for child and dependent care expenses.		28	170	00
All others: Single,	23	Attach Schedule 2.		-		
\$4,700	30	Credit for the elderly or the disabled. Attach		-		
Head of household,		Schedule 3.		_		
\$6,900	31	Education credits. Attach Form 8863.		-		
Married filing jointly or	32	Retirement savings contributions credit. Attach				
Qualifying widow(er),		Form 8880. 32	_			
\$7,850	33 34	Child tax credit (see page 36). 33 Adoption credit. Attach Form 8839. 34		-		
Married filing	35	Add lines 29 through 34. These are your total credits.		35	0	00
separately, \$3,925	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0		36	176	00
φ3,923	37	Advance earned income credit payments from Form(s) W-2.		37		
	38	Add lines 36 and 37. This is your total tax.	•	38	176	00
	39	Federal income tax withheld from Forms W-2				
	40		19 00	-		
If you have	40	2002 estimated tax payments and amount applied from 2001 return. 40				
a qualifying	41	Earned income credit (EIC). 41		-		
child, attach Schedule	42	Additional child tax credit. Attach Form 8812. 42				
EIC.	43	Add lines 39 through 42. These are your total payments.		43	619	00
Refund	44	If line 43 is more than line 38, subtract line 38 from line 43.		4.4	4.45	
Direct	45a	This is the amount you overpaid. Amount of line 44 you want refunded to you.		44 45a	443 443	00
deposit?		Routing Routin		40a	440	00
See page 47 and fill in	▶ b	number	3			
45b, 45c,	▶ d	Account				
and 45d.		number		_		
	46	Amount of line 44 you want applied to your				
		2003 estimated tax. 46		-		l
Amount	47	Amount you owe. Subtract line 43 from line 38. For details on how to pay, see page 48.		47		
you owe	48	Estimated tax penalty (see page 48). 48		71		
Third party	, [Do you want to allow another person to discuss this return with the IRS (see page 49)?	Yes.	Complete the f	ollowing.	☐ No
Third party designee		Designee's Phone Pr	ersonal ider	ntification		
			umber (PIN)			Ш
Sign	ŀ	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and solved and belief, they are true, correct, and accurately list all amounts and sources of income I received.	eived during			
here		of preparer (other than the taxpayer) is based on all information of which the preparer has any knowle your signature Your occupation Date Your occupation	edge.	Daytime pho	one numbe	r
Joint return? See page 20.		Kirk J. Evergreen 3/16/03 Retired		()		
Keep a copy for your		Spouse's signature. If a joint return, both must sign. Date Spouse's occupation		<u> </u>		
records.	y]	Mary Evergreen 3/16/03 Clerk				
Paid	F	Preparer's Date Check if		Preparer's SS	N or PTIN	·
preparer's	_	signature self-empl		<u> </u>		
use only)	Firm's name (or ours if self-employed), address and ZIP code		: ()		
l 		_	none no.	Form	1040A (2003)
		❸		1 01111	IUTUM (_002)

Social Security Benefits Worksheet

Social Seci	urity Benefit	ts Worksheet—Lines 14a and 14b	Keep for Your Record
Before you	begin: 🗸	Complete Form 1040A, lines 16 and 17, if it applies to you.	4
	\checkmark	If you are married filing separately and you lived apart from your spouse enter "D" to the right of the word "benefits" on line 14a.	for all of 2002,
	\checkmark	Be sure you have read the Exception on page 30 to see if you can use this instead of a publication to find out if any of your benefits are taxable.	s worksheet
1. Enter the tot	al amount from bo	x 5 of all your Forms SSA-1099 and Forms RRB-1099 17,2	00
2. Is the amou	nt on line 1 more	than zero?	
□ No. ST	OP)	social security benefits are taxable.	
	ter one-half of line		3,600
		1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts f	
		RRB-1099	
4. Enter the ar	nount, if any, from	n Form 1040A, line 8b	
5. Add lines 2	, 3, and 4		
6. Add the am	ounts on Form 10-	40A, lines 16 and 17	6900
7. Is the amou	nt on line 6 less t	han the amount on line 5?	
□ No. ST	None of your	social security benefits are taxable.	
X Yes. Sul	btract line 6 from	line 5	720,160
from your s		of household, qualifying widow(er), or married filing separately and you lived a 2002; \$32,000 if married filing jointly; -0- if married filing separately and you lin 2002	
9. Is the amou	nt on line 8 less t	han the amount on line 7?	
X No. ST	✓ None of your or 14b of For	social security benefits are taxable. You do not have to enter any amount on line rm 1040A. But if you are married filing separately and you lived apart from 10 f 2002, enter -0- on line 14b. Be sure you entered "D" to the right of the value 14a.	your
Yes. Sub	otract line 8 from 1	line 7	9.
from your s	00 if single, head of 2 pouse at any time	of household, qualifying widow(er), or married filing separately and you lived a 000; \$12,000 if married filing jointly; -0- if married filing separately and you lin 2002	part ived 10.
	•	If zero or less, enter -0	11.
	naller of line 9 or		12.
3. Enter one-h	alf of line 12.		13.
		line 13	
). If line 11 is zero, enter -0-	
• •			16
			17.
3. Taxable soc	cial security bene	fits. Enter the smaller of line 16 or line 17	18.
• Enter the	e amount from line	e 1 above on Form 1040A, line 14a.	
• Enter the	amount from lin	e 18 above on Form 1040A, line 14b.	

Problem 2

- 4040	Dena	artment of the Treasury—Internal Revenue S	Service O					
1040		6. Individual Income Tax Ret	<i>□</i>))((\\ ■	2 (99) IF	RS Use Only—Do not	write or sta	aple in this space.	
		the year Jan. 1-Dec. 31, 2002, or other tax year begin		2002, ending	. 20		B No. 1545-0074	
Label	-	ur first name and initial	Last name	,			ial security numb	er
(See	Pa	111	Birch			000	:00:432	1
instructions A		a joint return, spouse's first name and initial	Last name				s social security n	
on page 19.)	17/7		Birch			-	0 222	
Use the IRS	Ho	me address (number and street). If you have a	P.O. box, see page	19.	Apt. no.			<u> </u>
Otherwise, E	12	3 Green Street					nportant!	
please print R		y, town or post office, state, and ZIP code. If y	you have a foreign a	ddress, see page 1	9.		u must enter ır SSN(s) above.	
or type. Presidential	Cl	aremont, CA 91711					11 3314(s) above.	
Election Campaig	n 👠	Note. Checking "Yes" will not change y	your tax or reduce	e your refund.		You	Spous	е
(See page 19.)		Do you, or your spouse if filing a joint r				x Yes	No ⊠Yes	No
	1	Single		4 Head of	household (with g	ualifying p	person). (See page	19.) If
Filing Status	2	X Married filing jointly (even if only one	had income)				ot your dependent	,
Check only	3	Married filing separately. Enter spous	e's SSN above	this child	's name here. ▶			
one box.		and full name here. ▶		_ 5 🔲 Qualifyii	ng widow(er) wit	h depen	dent child (year	
				spouse	died ►)	. (See pa	-	
F	6a	7		you as a depend	ent on his or he		No. of boxes checked on	
Exemptions		return, do not check box	к 6a				and 6b	2_
	b	X Spouse			dent's (4) if qual		No. of children on 6c who:	
	С	Dependents:	(2) Dependent social security nu	S relationeh	ip to child for chil	d tax	lived with you _	
		(1) First name Last name	30Clar Security III	you	credit (see pa		did not live with	
If more than five			1 1				ou due to divorce or separation	
dependents,			1 1				see page 20)	
see page 20.			: :		- 		Dependents on 6c not entered above _	
							Add numbers	
	d	Total number of exemptions claimed					on lines above ▶	2
-		·		<u> </u>		7	28,542	00
Income	7 8a	Wages, salaries, tips, etc. Attach Form(Taxable interest. Attach Schedule B if	. ,			8a	478	00
Attack	b	Tax-exempt interest. Do not include or	•					
Attach Forms W-2 and	9	Ordinary dividends. Attach Schedule B			<u>'</u>	9	559	00
W-2G here.	10	Taxable refunds, credits, or offsets of s				10		
Also attach Form(s) 1099-R	11	Alimony received				11		
if tax was	12	Business income or (loss). Attach Sche	dule C or C-EZ			12	7,350	00
withheld.	13	Capital gain or (loss). Attach Schedule				13	7,202	00
	14	Other gains or (losses). Attach Form 47	97			14		
If you did not	15a	IRA distributions 15a		b Taxable amoun	t (see page 23)	15b		
get a W-2, see page 21.	16a	Pensions and annuities 16a		b Taxable amoun	t (see page 23)	16b		
see page 21.	17	Rental real estate, royalties, partnerships	s, S corporations,	trusts, etc. Attac	h Schedule E	17		
Enclose, but do	18	Farm income or (loss). Attach Schedule	e F			18		
not attach, any payment. Also,	19	Unemployment compensation				19		
please use	20a	Social security benefits . 20a		b Taxable amoun		20b		
Form 1040-V.	21 22	Other income. List type and amount (see Add the amounts in the far right column f	ee page 27) for lines 7 through	21 This is your to	atal income	21	44,131	00
				00	tar income P		11,101	
Adjusted	23 24	,						
Gross	25	IRA deduction (see page 27) Student loan interest deduction (see page 27)						
Income	26	Tuition and fees deduction (see page X	,					
	27	Archer MSA deduction. Attach Form 88				*//////		
	28	Moving expenses. Attach Form 3903						
	29	One-half of self-employment tax. Attach		29	520 00			
	30	Self-employed health insurance deducti		30				
	31	Self-employed SEP, SIMPLE, and quality	,	0.4				
	32	Penalty on early withdrawal of savings		00				
	33a	Alimony paid b Recipient's SSN ▶	and the second second	33a				_
	34	Add lines 23 through 33a				34	520	00
	35	Subtract line 34 from line 22. This is yo	our adjusted gros	s income	<u> </u>	35	43,611	00
For Disclosure, F	Privacy	Act, and Paperwork Reduction Act No	otice, see page 7	2 . (Cat. No. 11320B		Form 1040	(2002)

Form 1040, page 2

form 1040 (2002)					age 2
Tax and	36	Amount from line 35 (adjusted gross income)	36	43,611	00
Credits	37a	Check if: You were 65 or older, Blind; Spouse was 65 or older, Blind.			
Standard		Add the number of boxes checked above and enter the total here ▶ 37a			
Deduction	b	If you are married filing separately and your spouse itemizes deductions, or			
or— People who		you were a dual-status alien, see page 31 and check here ▶ 37b □	20	P 0E0	
checked any r	38	Itemized deductions (from Schedule A) or your standard deduction (see left margin).	38	7,850	
oox on line 37a or 37b or	39	Subtract line 38 from line 36	//////	35,761	00
who can be claimed as a	40	If line 36 is \$103,000 or less, multiply \$3,000 by the total number of exemptions claimed on	40	6 000	
dependent,		line 6d. If line 36 is over \$103,000, see the worksheet on page 32	41	6,000	00
see page 31. • All others:	41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0- Tax (see page 33). Check if any tax is from a Form(s) 8814 b Form 4972	42	29,761 3,506	00
Single,	42 43	(1 9)	43	0,000	00
\$4,700	43 44	Alternative minimum tax (see page 34). Attach Form 6251	44	3,506	
Head of household,	45	Add lines 42 and 43		0,000	
\$6,900	45 46	Credit for child and dependent care expenses. Attach Form 2441			
Married filing	47	Credit for the elderly or the disabled. Attach Schedule R			
ointly or Qualifying	48	Education credits. Attach Form 8863			
widow(er),	49	Retirement savings contributions credit. Attach Form 8880			
37,850 Married	5 0	Child tax credit (see page XX)			
iling	51	Adoption credit. Attach Form 8839			
separately,	52	Credits from: a Form 8396 b Form 8859 52			
,0,020	53	Other credits. Check applicable box(es): a Form 3800			
	-	b ☐ Form 8801			
	54	Add lines 45 through 53. These are your total credits	54		
	55	Subtract line 54 from line 44. If line 54 is more than line 44, enter -0	55	3,506	00
\	56	Self-employment tax. Attach Schedule SE	56	1,039	OC
Jiner	57	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	57	,	
axes	58	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required .	58		
	59	Advance earned income credit payments from Form(s) W-2	59		
	60	Household employment taxes. Attach Schedule H	60		
	61	Add lines 55 through 60. This is your total tax	61	4,545	00
ayments	62	Federal income tax withheld from Forms W-2 and 1099 62 4,575 00	<i>Y//////</i>		
	63	2002 estimated tax payments and amount applied from 2001 return . 63 1,625 00			
	64	Earned income credit (EIC)			
qualifying child, attach	65	Excess social security and tier 1 RRTA tax withheld (see page 51)			
	66	Additional child tax credit. Attach Form 8812 66			
	67	Amount paid with request for extension to file (see page 51) 67			
	68	Other payments from: a Form 2439 b Form 4136 68		0.00=	
	69	Add lines 62 through 68. These are your total payments	69	6,200	00
Refund	70	If line 69 is more than line 61, subtract line 61 from line 69. This is the amount you overpaid	70	1,655	00
irect deposit?	71a	Amount of line 70 you want refunded to you	71a	1,655	00
ee page 51 had fill in 71b,	► b	Routing number			
1c, and 71d.	- d	Account number			
ic, and i iu.		Amount of line 70 you want applied to your 2003 estimated tax 72	<i>\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\\</i>		I
	72	, ,, ,	70		
mount	73	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ▶	73		
Amount You Owe	73 74	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)		to the following	
mount ou Owe	73 74	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ▶		te the following.	<i>/////</i> □ N
mount ou Owe hird Party	73 74 Do	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)	Comple	te the following.	<i>∭</i> N
mount ou Owe hird Party esignee	73 74 Do Des	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)	Comple	·	
Amount You Owe Third Party Designee	73 74 Do Des nar	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)	Comple cation	pest of my knowledg	e and
Amount You Owe Third Party Designee Sign Here	73 74 Do Des nar Und beli	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ▶ Estimated tax penalty (see page 52)	Complection do to the which prepared	pest of my knowledg	e and
Imount You Owe Third Party Designee Sign Here Dint return?	73 74 Do Dee nar Und beli	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)	Complection do to the which prepared	pest of my knowledg arer has any knowled	e and
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Amount You Owe Chird Party Designee Sign Here Dint return? eep age 19. eep a copy or your	73 74 Do De: nar Und beli You Pro Spo	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)	Complection do to the which prepared	pest of my knowledg arer has any knowled	e and
Amount You Owe Third Party Designee Sign Here oint return? idee page 19. Keep a copy or your ecords.	73 74 Do Des nar Und beli You Pro Spo	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ▶ Estimated tax penalty (see page 52)	Complete cation In the cation Dayting Complete Cation Dayting Complete Cation Dayting Complete Cation Cation Complete Cation Cation Complete Cation Cation Complete Cation Cation Cation Cati	poest of my knowledg parer has any knowled me phone number	e and
Amount You Owe Third Party Designee Sign Here Joint return? See page 19. Keep a copy or your ecords. Paid	73 74 Do Dei nar Und beli You Pre	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 Estimated tax penalty (see page 52)	Complete cation In the cation Dayting Complete Cation Dayting Complete Cation Dayting Complete Cation Cation Complete Cation Cation Complete Cation Cation Complete Cation Cation Cation Cati	pest of my knowledg arer has any knowled	e and
Amount You Owe Third Party Designee Sign Here oint return? idee page 19. Keep a copy or your ecords.	T3 T4 Do Des nar Und beli You Pre sig Firm	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ► Estimated tax penalty (see page 52)	Complete cation In the cation Dayting Complete Cation Dayting Complete Cation Dayting Complete Cation Cation Complete Cation Cation Complete Cation Cation Complete Cation Cation Cation Cati	poest of my knowledg parer has any knowled me phone number	e and

Comprehensive Problems CP-17

PENSION EARNER

2002 Schedule B

Schedules A&B (Forn	n 1040) 2002	OMB N	No. 1545-0074 P	age 2
` '	orm 1040. Do not enter name and social security number if shown on other side.		ur social security nu	
Paul and Ma	ary Birch	00	00 00 432	1
	Schedule B—Interest and Ordinary Dividend	S	Attachment Sequence N	o. 08
Part I nterest	1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶		Amount	
See page B-1 nd the estructions for	Main Street Bank		478	00
orm 1040, ne 8a.)				
lata If you		1		
lote. If you eceived a Form 099-INT, Form 099-OID, or				
ubstitute tatement from brokerage firm,				
st the firm's name as the payer and enter				
he total interest	2 Add the amounts on line 1	2	478	00
orm.	3 Excludable interest on series EE and I U.S. savings bonds issued after 1989 from Form 8815, line 14. You must attach Form 8815	3		
	4 Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ► Note. If line 4 is over \$400, you must complete Part III.	4	478	00
			Amount	
art II Ordinary	5 List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13 ▶			
ividends	ABC Corporation		242	00
See page B-1 nd the	XYZ Corporation		317	00
estructions for orm 1040, ne 9.)				
lote. If you eceived a Form 099-DIV or		5		
ubstitute tatement from brokerage firm, st the firm's				
ame as the ayer and enter ne ordinary				
ividends shown n that form.				
	6 Add the amounts on line 5. Enter the total here and on Form 1040, line 9 . ▶ Note. If line 6 is over \$400, you must complete Part III.	6	559	00
art III	You must complete this part if you (a) had over \$400 of taxable interest or ordinary divforeign account; or (c) received a distribution from, or were a grantor of, or a transferor to			No
oreign accounts	7a At any time during 2002, did you have an interest in or a signature or other author account in a foreign country, such as a bank account, securities account,	or othe	V//////	//////////x
and Trusts	account? See page B-2 for exceptions and filing requirements for Form TD F S b If "Yes," enter the name of the foreign country ▶ During 2002, did you receive a distribution from, or were you the grantor of, s		feror to, a	
age B-2.)	foreign trust? If "Yes," you may have to file Form 3520. See page B-2			X
or Paperwork Re	eduction Act Notice, see Form 1040 instructions.	Sched	ule B (Form 1040)	2002
	❸			

Schedule C-EZ

(For	HEDULE C-EZ rm 1040) tment of the Treasury al Revenue Service (99)		(Sole Pro ships, joint ventures, e	rom Business prietorship) etc., must file Form 1065 on 11. See instructions on			OMB No. 154 200 Attachment Sequence No.	12
Name	e of proprietor	Birch				ial secu	urity number (S	SN)
Pa		nformation				000:	00 ; 888	, I
School School	May Use edule C-EZ ead of edule C y If You:	 Had business expless. Use the cash meti Did not have an ir time during the ye Did not have a ner business. Had only one busiproprietor. 	nod of accounting. eventory at any ear. t loss from your	And You:	Had no emplo Are not requir Depreciation a this business. for Schedule C-3 to find ou Do not deduc business use Do not have p passive activit business.	ed to fill and Am See th C, line that if you to expend of your prior year.	le Form 4562, nortization, for e instructions 13, on page must file. uses for home. ar unallowed	
Α	Principal business of	or profession, including I	product or service		В		ode from pages	
	Crafts Instruc	etor o separate business na	ma Jagya blank				8 1 2 9 er ID number (E	
	business name. If it	o separate business na	me, leave blank.			Ellipioy		any
Par		office, state, and ZIP coo	de					
1	employee" box or		ked, see Statutory E	on Form W-2 and the "St mployees in the instructi 		1	7,80	00 00
2	Total expenses.	f more than \$2,500, y	you must use Sched	lule C (see instructions)		2	48	50 00
3	Form 1040, line 1	12, and also on Sche	edule SE, line 2. (Sta	ou must use Schedule (tutory employees do not n Form 1041, line 3.)		3	7,3	50 00
Pa	rt III Informati	on on Your Vehicle	. Complete this pa	rt only if you are claimi	ing car or tr	uck ex	penses on	line 2.
4	When did you pla	ce your vehicle in sei	vice for business pu	rposes? (month, day, yea	ar) ►			
5	Of the total numb	er of miles you drove	your vehicle during	2002, enter the number	of miles you	used y	our vehicle f	or:
а	Business	b	Commuting	c Other	r			
6	Do you (or your s	pouse) have another	vehicle available for	personal use?			. 🗌 Yes	□ No
7	Was your vehicle	available for persona	I use during off-duty	hours?			. 🗆 Yes	□ No
8a	Do you have evide	ence to support your	deduction?				. 🗌 Yes	☐ No
						<u> </u>	. 🗌 Yes	□ No
For I	Paperwork Reductio	n Act Notice, see Forn	n 1040 instructions.	Cat. No. 14374D	Sch	edule (C-EZ (Form 1	040) 2002

2002 Schedule SE

SCHEDULE SE (Form 1040)

Self-Employment Tax

► Attach to Form 1040. ► See Instructions for Schedule SE (Form 1040).

2002 Attachment Sequence No. 17

OMB No. 1545-0074

Name of person with **self-employment** income (as shown on Form 1040)

Mary Birch

Social security number of person with self-employment income ▶

000 00 2221

Who Must File Schedule SE

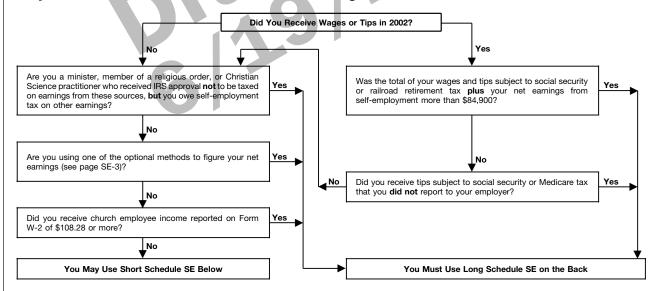
You must file Schedule SE if:

- You had net earnings from self-employment from other than church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more or
- You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order is not church employee income. See page SE-1.

Note. Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE. See page SE-3.

Exception. If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt–Form 4361" on Form 1040, line 56.

May I Use Short Schedule SE or Must I Use Long Schedule SE?



Section A-Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (For 1065), line 15a			
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1061 line 15a (other than farming); and Schedule K-1 (Form 1065-B), box 9. Ministers and member of religious orders, see page SE-1 for amounts to report on this line. See page SE-2 for other	ers		
	income to report	-	7,350	00
3	Combine lines 1 and 2		7,350	00
4	Net earnings from self-employment. Multiply line 3 by 92.35% (.9235). If less than \$40 do not file this schedule; you do not owe self-employment tax	0,	6,788	00
5	Self-employment tax. If the amount on line 4 is:			
	• \$84,900 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 56.	. 5	1,039	00
	 More than \$84,900, multiply line 4 by 2.9% (.029). Then, add \$10,527.60 to the result. Enter the total here and on Form 1040, line 56. 			
6	Deduction for one-half of self-employment tax. Multiply line 5 by 50% (.5). Enter the result here and on Form 1040, line 29 6 520	00		
For	Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11358Z	Schedu	le SE (Form 1040)	2002

Comprehensive

2002 Schedule D, page 1

SCHEDULE D (Form 1040)

Capital Gains and Losses

▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.

► Attach to Form 1040. ► See Instru

► See Instructions for Schedule D (Form 1040).

OMB No. 1545-0074

2002

Attachment
Sequence No. 12

Department of the Treasury Internal Revenue Service (99) Name(s) shown on Form 1040

Your social security number

Par	ıl and Mary	Birch					000	0 00 4321	
art I Short-Term Ca	pital Gains a	nd Losse	s—Assets Held C	ne Year or	Less				
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date so (Mo., day,)		(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (I Subtract (e) fro			
					V				
Enter your short-term Schedule D-1, line 2.	totals, if any	, from	2						
Total short-term sale Add lines 1 and 2 in coli		nounts.	3						
Short-term gain from Fo				orms 4684,	_				
					4				
Net short-term gain or (lo from Schedule(s) K-1			corporations, estates		5				
Short-term capital loss 2001 Capital Loss Carry					6	()		
Net short-term capital	gain or (loss).	Combine I	lines 1 through 6 in a	column (f).	7				
			s—Assets Held M			ear	:	<u> </u>	
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date so (Mo., day,)		(e) Cost or othe (see page D-5 instruction	of the	(f) Gain or (I Subtract (e) fro		(g) 28% rate gain of (loss) * (see instr. below)	
200 sh. ABC Corp	11/21/98	7/9/0	3,300 00	3,777	00	(477	00)		
500 sh. XYZ Corp	2/18/00	10/23/0	02 25,000 00	17,500	00	7,500	00		
Enter your long-term Schedule D-1, line 9 .			9						
Total long-term sale Add lines 8 and 9 in col	es price an	nounts.	10 28,300 00						
Gain from Form 4797, I long-term gain or (loss)					11				
Net long-term gain or (lo from Schedule(s) K-1.	ss) from partne	erships, S c	corporations, estates	and trusts	12				
Capital gain distributions	s Soo paga D	1 of the inc	structions		13	179	00		
 Capital gain distributions. See page D-1 of the instructions Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet 						()	(
any, from line 13 of your 2001 Capital Loss Carryover worksneet									
Combine lines 8 through	14 in column	(g)	Combine lines 8 through 14 in column (g) Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.						

^28% **rate gain or loss** includes **all** "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11338H

Schedule D (Form 1040) 2002

2002 Schedule D, page 2

17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41, is more than zero, complete. Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete. Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040. 18 If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39 Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. • Otherwise, and Skip all of the Interest of Form 1040. • Otherwise, and Skip all of the Interest elsow. Otherwise, go to line 20. 20 Enter your trazable income from Form 1040, line 41 21	chedule D (F	form 1040) 2002		P	age 2
Form 1040, line 13, and complete Form 1040 through line 41. 17,808 17,808 17,808 18 18 18 19 19 19 19 1	Part III	Taxable Gain or Deductible Loss		T	
Part IV below. Otherwise, skip the rest of Schedule D and complete Form 1040. If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39 Next: If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. Otherwise, skip Part IV below and complete the rest of Form 1040. Otherwise, skip Part IV below and complete the rest of Form 1040. Part IV Tax Computation Using Maximum Capital Gains Rates II Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20. If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, enter the amount of the page 12 form line 21 fizer or less, enter -0- Subtract line 23 from line 20. If zero or less, enter -0- Subtract line 23 from line 20. If zero or less, enter -0- The amount on line 20 or Satisfied if head of household; or \$23,350 if single; \$37,450 if head of household; or \$23,350 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines Part IV below and complete the capital Loss of Form 1040, line 30 to line 34. Filter the amount form line 26. If zero or less, enter -0- and go to line 34. Filter the smaller of line 28 or line 29. Capital			17	7,202	00
(b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39 Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Gapriat Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. Part IV Tax Computation Using Maximum Capital Gains Rates 19 Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions . 19 If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20. 20 Enter your taxable income from Form 1040, line 41	Next	Part IV below.			
than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. Part IV Tax Computation Using Maximum Capital Gains Rates 19 Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions			18	(()
Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions .	Next	than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040.			
Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions .	Part IV	Tax Computation Using Maximum Capital Gains Rates			
21 Enter the smaller of line 16 or line 17 of Schedule D	9 Enter if any page If line page 22, 2	your unrecaptured section 1250 gain, from line 17 of the worksheet on D-7 of the instructions			
21 Enter the smaller of line 16 or line 17 of Schedule D	D Enter	vour taxable income from Form 1040, line 41 20 29,761 00	\ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \ \		
22 If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0- 23 Subtract line 22 from line 21. If zero or less, enter -0- 24 Subtract line 23 from line 20. If zero or less, enter -0- 25 Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies 26 Enter the smaller of: • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34. 27 Enter the amount from line 24 28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 29 Enter the smaller of line 28 or line 29 30 Enter the smaller of line 28 or line 29 31 Multiply line 30 by 8% (0.8) 32 Subtract line 30 from line 28 33 Enter the 30 from line 28 34 P.202 00	1 Enter	the smaller of line 16 or line 17 of			
23	2 If yo exper	u are deducting investment interest ase on Form 4952, enter the amount			
Subtract line 23 from line 20. If zero or less, enter -0- 24		offit 4932, fille 4e. Offier wise, effect -0-	\ <i>\\\\\</i>		
Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies Enter the smaller of: The amount on line 20 or \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34. Enter the amount from line 24 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 Enter the smaller of line 28 or line 29 Multiply line 30 by 8% (.08) Subtract line 30 from line 28 The control of the worksheet on page D-8 Subtract line 30 from line 28 The control of the worksheet on page D-8 Subtract line 30 from line 28 The control of the worksheet on page D-8 Subtract line 30 from line 28 The control of the worksheet on page D-8 Subtract line 30 from line 28		24 99 550 00	- //////		
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• \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34. 27 Enter the amount from line 24	. •	•			
\$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34. 27 Enter the amount from line 24 28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 29 Enter the smaller of line 28 or line 29 30 Enter the smaller of line 28 or line 29 31 Multiply line 30 by 8% (.08) 32 Subtract line 30 from line 28 33 Enter the solution of line 28 34 P,202 35 Pool		\(\frac{\psi}{\psi}\)			
\$37,450 if head of household; or \$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34. 27 Enter the amount from line 24 28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 30 Enter the smaller of line 28 or line 29 31 Multiply line 30 by 8% (.08) 32 Subtract line 30 from line 28 33 Frank Subtract line 30 from line 28 34 Frank Subtract line 30 from line 28 35 Frank Subtract line 30 from line 28 36 Frank Subtract line 30 from line 28 37 Frank Subtract line 30 from line 28		00 861 00) <i> </i>		
\$23,350 if married filing separately If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34. 27 Enter the amount from line 24		, soo in single,			
27 through 33 and go to line 34. 27 Enter the amount from line 24 28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 30 Enter the smaller of line 28 or line 29 31 Multiply line 30 by 8% (.08) 32 Subtract line 30 from line 28 33 2 7,202 00					
27 through 33 and go to line 34. 27 Enter the amount from line 24 28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 30 Enter the smaller of line 28 or line 29 31 Multiply line 30 by 8% (.08) 32 Subtract line 30 from line 28 33 2 7,202 00	If line	26 is greater than line 24, go to line 27. Otherwise, skin lines			
28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8		- V/////			
28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34 29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8	7 Entor	the amount from line 24) <i>//////</i>		
29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8 . 29 29 30 Enter the smaller of line 28 or line 29		The difficult from the 24	J /////		
30 Enter the smaller of line 28 or line 29					
31 Multiply line 30 by 8% (.08)					
32 Subtract line 30 from line 28		the stitutes of the 20 of the 20	_/////		
NOO.					
33 Multiply line 32 by 10% (.10)		oly line 32 by 10% (.10)	33	720	00
If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.					
34 Enter the smaller of line 20 or line 23			-\////		
35 Enter the amount from line 28 (if line 28 is blank, enter -0-)		the amount normine 20 (if fine 20 is blank, effect 0)	-\////		
37 Multiply line 36 by 20% (.20)		dot into do front inte o4	37		
38 Add lines 25, 31, 33, and 37	B Add I	ines 25, 31, 33, and 37		3,506	00
Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies 3,866	9 Figure	e the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	3,866	00
Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42			40	3 506	00
and on Form 1040, line 42	anu (71 I O I II I 1040, III IC 42			

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